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SPECIAL PROCEDURAL MEASURES ADOPTED AND THE OBSERVANCE OF THE HUMAN RIGHTS - ROMANIA'S REPORT -

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Key words: *Romanian criminal procedure, special procedural measures, human rights, presumption of innocence, the right to habeas corpus*

Section I

Reform of legal framework: special measures with regard to prevention, investigation, and prosecution

1. Introduction

One cannot fail to notice that the recent evolution of Romanian criminal procedure - due to the emergence of grievous criminality phenomena and to the influence of globalization - has acquired new characteristics: the conciliation between the general and individual or particular interests; the adoption of new different procedural measures, according to the gravity of the committed offences; the escalating denationalization process of criminal procedure, in conformity with the pattern of other procedures. One can say that ever since 1990, when the Romanian political regime changed, our criminal procedure has been undergoing continuous transformation. In all this period many laws have been adopted with a view to alter and complete the Code of Criminal Procedure^{iv}. Among these law, the most important are the following ones (adopted in the last decade): Law no. 141/1996^v, the Government Emergency Ordinance no. 207/2000^{vi} partially and temporarily suspended by Government Emergency Ordinance no. 295/2000^{vii} approved with modifications and adnotations by the Law 456/2001^{viii}, Law 296/2001^{ix}, subsequently repealed by Law 302/2004^x, Law no. 704/2001^{xi}, repealed by Law no. 302/2004, Law no. 756/2001^{xii}, Law no. 169/2002^{xiii}, repealed by Law no. 302/2004, Government Emergency Ordinance no. 58/2002^{xiv}, approved with modifications by Law no. 161/2005^{xv}, Government Emergency Ordinance no. 93/2002^{xvi}, approved by Law no. 574/2002^{xvii}, Law no. 281/2003^{xviii}, Government Emergency Ordinance no. 66/2003^{xix}, approved by Law no. 359/2003^{xx}, Government Emergency Ordinance no. 109/2003^{xxi}, approved, with modifications and adnotations^{xxii} by Law no. 159/2004, Government Emergency Ordinance no. 55/2004^{xxiii}, approved, with modifications and adnotations, by Law no. 548/2004^{xxiv}, Law no. 302/2004^{xxv}, Government Emergency Ordinance no. 72/2004^{xxvi}, approved by Law no. 575/2004^{xxvii}, Law no. 480/2004^{xxviii}, Law no. 576/2004^{xxix}, Government Emergency Ordinance no. 190/2005^{xxx}, approved, with modifications and adnotations by Law no. 332/2006^{xxxi}, Law no. 356/2006^{xxxii}, Government Emergency Ordinance no. 60/2006^{xxxiii}, Law no. 79/2007^{xxxiv}, Government Emergency Ordinance no. 31/2008^{xxxv} and Law n r. 57/2008^{xxxvi}.

This permanent reform attests the instrumentalization of criminal procedure which is enforced by the legislative. In our country, as it happens all over the world, the fight against criminality has become a main objective in public debates and any criminal fact is regarded as a pretext for making and passing a law. Parliament reacts to every particular mediatized case

by issuing a normative act. But, beyond this legislative proselytism, the multi-sized reform is a consequence of a profound change in Romanian criminal procedure and of a major conflict existing between two actual models, the one based on the European Convention, which relies on individual freedoms observance, and the one of particular techniques used for criminal investigations, which relies on public security. Romanian criminal procedure is traditionally inquisitorial and it gives many prerogatives to the judicial police and the prosecutor, under the partial control of the judge, who is more and more present in our country in preliminary procedures, i.e. in the stage of preliminary acts and in the preliminary stage of criminal proceedings (the stage of criminal prosecution). However, this model has been considerably modified recently, since individual freedoms protection has been reinforced and the suspect^{xxxvii} or the accused one^{xxxviii} has been offered more rights, in accordance with the European Convention of Human Rights. At the same time, however, a contrary direction has come into being and it hints at strengthening the investigation powers, to the detriment of individual freedom, in order to fight more efficiently against the grievous forms of criminality. This tendency manifested itself especially after 2000 and it is supported by the concern to fight more energetically against organized crime and terrorism.

2. Which are the treaties concerning human rights and humanitarian law (The Geneva Convention, for example) that are applied in the internal system of law, if there are limitations in applying these international dispositions in our country and if the citizens (those suspected of having committed an offence, those incriminated or accused, the victims of offences and witnesses) can invoke norms of these international acts within the internal judicial activities?

As to the guarantee of the human rights, Romania has ratified the most important international instruments it has adopted, as follows: Geneva Conventions relative to the protection of the victims of international armed conflicts (12.08.1949)^{xxxix}; the international Agreement relative to the economic, social and cultural rights (16.12.1966); the international Agreement relative to the civil and political rights (16.12.1966)^{xl}; the Convention against torture and other punishments or cruel inhuman and degrading treatment (New York, 10.12.1980)^{xli}; the European Convention for preventing torture and punishments or inhuman and degrading treatment (Strasbourg, 4.11.1987), and the Protocols no. 1 and 2 (Strasbourg, 4.11.1993)^{xlii}; the European Convention relative to the imprescriptibility of crimes against humanity and of crime wars (Strasbourg, 25.01.1974)^{xliii}; the European Convention for safeguarding human rights and fundamental freedoms, with additional protocols^{xliv}.

The dispositions provided by these international instruments can be quoted by the parties involved in the criminal judiciary procedures. International acts mentioned above are not limited by internal provisions. In this respect, for example, by Law no. 277/2002 Romania has retracted the reserves formulated in the four Geneva Conventions relative to the protection of war victims. At the same time, by passing the Law no. 345/2004 Romania has retracted the reserve formulated in article 5 in the Convention relative to the safeguarding of human rights and fundamental liberties.

According to the provisions included in article 20 (1) in the Constitution of Romania, the constitutional dispositions relative to the citizens' rights and freedoms shall be interpreted and applied in accordance with the Universal Declaration of Human Rights, as well as the agreements and the other treaties that Romania is part of. At the same time, if there are incongruencies between the agreements and the treaties relative to the fundamental human rights Romania is part of, and the internal laws, the international regulations are preeminent, except the case in which Constitution or internal laws include more favourable dispositions (article 20 (2) in the Constitution of Romania).

Our juridical system does not have limitations as to the application of the international dispositions, except the ones authorised by the Constitution. Thus, neither the restriction of the exercise of some rights nor the freedoms provided by the international treaties relative to the human rights and by the ones relative to the humanitarian law are admissible unless they respect the provisions included in the fundamental law. In this respect, article 53 (1) in the Constitution of Romania provides that the exercise of certain rights or of certain freedoms may only be restricted by law and only if necessary, if the case may be, for the defence of national security, of public order, health, or morals, of the citizens' rights and freedoms; conducting a criminal investigation. At the same time, section 2 of article 53 in the Constitution formulates the principle according to which restriction shall only be ordered if necessary in a democratic society, thus putting to good use the provisions of the international specific documents^{xlv}. At the same time, this article provides that the adopted measure shall be proportional to the situation which caused it, applied without discrimination, and without infringing on the existence of such right or freedom. Such a possibility is authorised, as we shall see in the fight against organized crime and terrorism, in which the tension between security and freedom is particularly evident. Restrictions imposed on the rights and freedoms are the ones provided by the Code of criminal procedure, in the laws adopted for altering and completing our legislation, and similarly in some special laws, while they also provide the use of exceptional procedural means, derogatory from common law.

In all cases, restrictions imposed on the rights and individual freedoms for the need to fight against organized criminality and terrorism are, in general, approved both by the Constitutional Court and the European Court of Human Rights. Thus, the Constitutional Court, which always takes into consideration the seriousness and complexity of the causes generating terrorism or the ones belonging to organized criminality, admits the use of particular procedural instrument in investigating offences with a view to safeguard constitutional rights, directly aggrieved by the terrorist threats or the ones of organized crime^{xlvi}. A particular situation is represented by the preliminary acts, which are highly legitimated by the humanitarian practices, as well as the strengthening of the authorities' prerogatives revealing the exclusive power and information practice of administrative and judicial police. The preliminary acts referred to in article 224 from the Romanian Code of Criminal Procedure can be concretely materialized as a multitude of facts "in order to gather evidence necessary to the criminal investigation bodies for the initiation of criminal investigation", as well as the surveillance of suspects, gathering statements, taking photos, making interceptions, as well as audio or video recordings etc. As far as these audio and video surveillance methods acts are concerned, it has been established^{xlvii} that the suspect could not be informed about his/her surveillance, so that he/she could hire a lawyer (of course, these surveillance methods are legal, as provided in article 91¹ and the next one in the Code of Criminal Procedure). A similar incompatibility would exist in the case of surveillance operations - accomplished by the specialized investigation state bodies - performed for persons who are suspected of having committed an offence and who have the right to a lawyer, situation in which these preliminary acts are no longer efficient. Such hypotheses, as well as other similar ones, would make the prevention activity and the deterrence of infrafractional phenomena impossible (especially when it is about organized crime) and because of that the general guarantee to the exercise of the constitutional right to defence is unacceptable, under the form of a prerogative ensurance of qualified juridical assistance. This consequence corresponds to the provisions of article 53 of the Constitution on the restriction of the exercise of certain rights and freedoms.

In conformity with the provisions of the European Court of Human Rights^{xlviii}, the measures adopted for fighting against terrorism and organized crime are perceived as necessary restrictions in a democratic society, while any state is allowed to consider the

extent to which these restrictions should be imposed. However, derogatory procedures applied to terrorism and organized crime involve the exercise of control over the measures adopted and the limitation of the main excesses that could come from the part of the Constitutional Court, by means of the **a priori** abstract control of constitutionality or the **a posteriori** concrete control (by means of the objections of unconstitutionality expressed in the courts of justice), as well as from the part of the European Court of the Human Rights. The limits imposed can refer also to the extension and the intensification of the derogatory procedures. For example, the derogatory regime from common law can not be extended to offences that lack the characteristics of organized crime offences or which could not be qualified as acts of terrorism or which are not necessarily related to such offences. At the same time, there are certain substantial guarantees which can never become the subject of a derogation, such as: absolute interdiction of torture and of inhuman and degrading treatment^{xi}, the right to defence – which can be limited but never be suspended, the development of the investigation and evidence research techniques on condition that they remain loyal and obey to a certain degree of equity^l. At the same time, restrictive measures should be considered admissible only on condition that they shall be subject to judicial control^{li}.

3. What important legislative reforms have been adopted in our country in the last decade with a view to ensure national or international security as well as public order?

In the last decade, new normative acts have been adopted in Romania including the regulations on national and international security or on public order. In this respect, two categories of laws are of great significance: the ones relative to preventing, revealing and sanctioning corruption acts (Law no. 78/2000 on preventing, revealing and sanctioning corruption acts^{lii}, with subsequent adnotations and modifications, Law no. 161/2003 on the measures necessary to ensure transparency in performing public offices, public offices in the business environment, preventing and sanctioning corruption^{liii} and Government Emergency Ordinance no. 43/2002^{liv}, with the subsequent changes and adnotations, concerning the National Anticorruption Directorate); laws on preventing and fighting against organized crime and terrorist (Law no. 39/2003 on preventing and fighting against organized crime^{lv}, Law no. 656/2002 on preventing and sanctioning money laundry, as well as for implementing measures for preventing and fighting against financing terrorism acts^{lvi}, Law no. 535/2004 on preventing and fighting against terrorism^{lvii}, Law no. 143/2000 on preventing and fighting against illicit drug dealing and consumption, with subsequent modifications and adnotations^{lviii}. Law no. 678/2001 on preventing and fighting against human trafficking^{lix} and Law no. 508/2004 on the setting up, organizing and functioning of the Directorate, for Investigating Organized Crime and Terrorist Offences^{lx} (within the Public Ministry) develop the idea of simplified criminal justice and the particular means for gathering evidence.

Special procedural regulations are adopted with Law no. 143/2000 whose provisions cover a long range of purposes from preventing and fighting against illicit drug dealing, with its subsequent adnotations and transformations, including the ones brought by Law no. 522/2004^{lxi} and by Government Emergency Ordinance no. 121 on 21st December 2006^{lxii}, which contains provisions on the impunity of the person who has committed one of the infractions provided by this law, and who during the criminal investigation denounces and facilitates the identification of other persons that have committed drug related offences (article 16), to authorizing surveilled drug dealings with or without the total substitution of the drugs or of the parties involved (article 20), authorizing the use of undercover investigators to reveal the illegal facts, identifying the authors and obtaining evidence tools (article 21), using collaborators (article 22), authorizing access on a specific period of time to

the telecommunication or computer based information systems and their monitoring (article 23) and authorizing medical investigations in order to detect the presence of drugs on someone when there is solid evidence that a person transports drugs on him/her. (article 25).

Similar provisions are included in Law no. 678/2001 on preventing and fighting against human trafficking, with subsequent modifications and adnotations^{lxiii}, which sets forth provisions on the impunity of the drug dealing participant who denounces and facilitates the identification and prosecution of other persons that have committed similar offences (article 20), on the use of undercover investigators, in conformity with the law (article 22), on the access and surveillance of telecommunication or computer based information systems (article 23) and on protecting human trafficking victims (article 26-44).

At the same time, the current Law no. 656/2002 (which replaced the former Law no. 21/1999 on preventing and sanctioning money laundry no. 21/1999^{lxiv}, with subsequent modifications and adnotations, especially the ones brought by the recent Government Emergency Ordinance no. 53/2008^{lxv}) – on preventing and sanctioning money laundry, as well as on implementing prevention and deterrence measures as to the financing of terrorist acts – contains provisions relative to the impunity of the person who has committed the offence provided in article 23, and who denounces and facilitates the identification and prosecution of the other participants to the offence committal (article 23¹), as well as to the inopposability of the bank secrecy and the professional secret of the prosecution bodies or courts of justice (article 26) and admits the possibility of taking measures, according to a special procedure meant to gather evidence or to identify the offender, to monitor the banking accounts and the accounts assimilated to them, to surveille, intercept or record conversations, to have access to the computer based information systems and surveilled delivery of the sums of money (article 27), as well as the possibility to use undercover investigators, under the conditions provided by the Code of Criminal Procedure (article 27¹).

In a similar way, Law no. 39/2003 – on preventing and fighting against organized crime – sets up (within the Ministry of Internal Affairs and Administrative Reforms) specialized structures for preventing and fighting against organized crime (article 12), providing the rule of impunity for collaborators before initiating criminal prosecution or after initiating criminal prosecution, as the case may be (article 9), and the rule of inopposability as to the bank secrecy and professional secret, except the professional secret of the lawyer, prosecutor, after criminal investigation begins, and of the courts of justice (article 14), offering the possibility to use special procedural measures in order to gather evidence or identify the offenders, by implementing special procedures for monitoring banking accounts and the accounts assimilated to them, monitoring communication systems or access to computer based information systems (article 15), allowing surveilled delivery to be made with or without the total substitution of the goods that represent the object of delivery (article 16), using undercover policemen from the specialized structures of the Ministry of Internal Affairs and Administrative Reform (article 17-20), using informers to collect data concerning the committal of offences and to identify the offenders (article 21-22), as well as by taking specific protection measures for witnesses, the undercover policeman, the informer and his/her family members.

In a similar way, Law no. 161/2003 – on certain measures adopted for ensuring transparency in the performance of public offices, of public offices in the business environment, for preventing and sanctioning corruption^{lxvi}, with all the subsequent modifications and adnotations, and for preventing and fighting against hacking offences (Title III) – includes provisions relative to preventing, identifying and sanctioning offences, including, among others, procedural measures conditioned by the existence of data or material evidence as to the preparation or committal of an offence by means of IT instruments, with a view to gather evidence or identify the offender, such as the immediate

conservation of computer data, or of the data reflecting information traffic, which are exposed to loss or destruction (article 54), collecting any objects that may contain information, data relevant for the information traffic or data relative to the users, with a view to make copies, which may be used as evidence (article 55), initiating computer data search, by appropriately applying the dispositions of the Criminal Procedure Code as to the domicile search (article 56), as well as the access to a computer based information system, including the interception and recording of conversations by means of computer based information systems, for which the dispositions of the Criminal Procedure Code are applied with reference to the audio and video recordings (article 57).

Finally, Law no. 535/2004 - on preventing and fighting against terrorism^{lxvii} - contains justified special procedural dispositions, as article 20 of the law stipulates, with a view to deter the threats to Romania's national security as provided in article 3 of the Law no. 51/1991 on Romania's national security^{lxviii}, including terrorism acts. They refer to the authorization of performing specific activities with a view to gather information, by intercepting and recording conversations, searching for information, documents or records for which permission is necessary: to have access to certain places, to an object, to be allowed to open an object, to lift or replace an object or document, to examine it or extract information included in it, to record, copy or obtain samples of it by any means, as well as by installing objects, maintaining them and removing them from the places in which they were installed and for which a special procedure is applied (article 21-22).

All these special procedural rules - used in the field of organized crime and terrorism - are concentrated in Law nr 508/2004, which regulates the setting up, organization and functioning of the Directorate for Investigating Organized Crime and Terrorism Offences (within the Public Ministry). Thus, after the National Anticorruption Directorate (NAD) was set up within the Public Ministry as a Public Prosecutor's Office specialized on fighting against corruption offences^{lxix}, by Law no. 508/2004, a second specialized Public Prosecutor's Office was set up in Romania: the Directorate for Investigating Organized Crime and Terrorism Offences (DIOCTO), as a body with juridical personality, specialized on fighting against organized crime and terrorism acts, within the Public Prosecutor's Office attached to the High Court of Cassation and Justice, whose main powers are: criminal investigations enforced for the offences stipulated in this law and in the special laws mentioned above, the conducting, surveilling and controlling of criminal prosecutions with the approval of the prosecutor by the officers and judicial police agencies coordinated by the DIOCTO, as well as the notification of the courts of justice for adopting the measures provided by law and for judging the causes concerning the offences which correspond to the DIOCTO jurisdiction. This law provides particular procedures assimilated with the ones existing in the criminal law that anticipate it, but they cover a larger area, since they are conceived for a large number of offences that come into the special jurisdiction of DIOCTO, and they are enumerated in article 12 of the law^{lxx}.

The particular procedures refer to the possibility of using as evidence the technical and scientific findings of the prosecutors from DIOCTO, on the basis of the written disposition of the prosecutor (article 10), the obligation of the persons that have ruling or control powers to notify DIOCTO as to any data or information which confirm the committal of one of the offences that come in the DIOCTO jurisdiction, as well as the obligation of the services and bodies specialized in gathering and processing information to immediately offer DIOCTO all the collected data and information that are linked with the committal of the offences provided in article 12, including the data and unprocessed information (article 13), authorized by DIOCTO to possess and to use proper means for obtaining, checking, processing, stocking and finding information concerning the offences that come in its jurisdiction, under the provisions of the law (article 15), the possibility to adopt special procedural measures in

conformity with the Code of Criminal Procedure or other special laws, such as: monitoring banking accounts and the accounts assimilated to them, surveilling, intercepting or recording conversations or having access to computer based information system (article 16), as well as the possibility to use undercover investigators or collaborators and judicial police informers under the conditions stipulated by the Code of Criminal Procedure and other special laws, authorizing the performance of surveillances with or without the total or partial substitution of the goods, merchandise or substances that make the object of the delivery, adopting specific measures for protecting witnesses, the experts and the victims, in conformity with the law, measures which are accompanied by the regulation of a special procedure to be adopted in this respect (article 18), to which another procedure is added for checking the banking accounts and the accounts assimilated to them, specifying that the bank secrecy and the professional secret, except the professional secret of the lawyer, exercised under the law conditions, are not opposable to the prosecutor, after the criminal investigation starts, nor are they opposable to the court of justice (article 19). Finally, article 21 clearly sets forth the applicability of the Criminal Procedure Code dispositions as well as of the dispositions of the laws passed in the cases that are lawfully assigned to DIOCTO.

The Government Emergency Ordinance no. 43/2002 relative to the National Anticorruption Directorate contains, for corruption offences or corruption related acts, procedural dispositions (article 14-24) similar with the ones provided for preventing and fighting against organized crime and terrorism, which constitute alternative procedural measures. These dispositions are completed by other procedural dispositions - provided by Law no. 78/2000 for preventing, identifying and sanctioning corruption acts (article 23-31) - and are in general similar to the ones exposed above, with some exceptions. Thus, as far as the use of undercover investigators is concerned, article 26¹ of the Law no. 78/2000 - introduced by Government Emergency Ordinance no. 124/2005^{lxxi} - contains provisions on the prosecutor's possibility to authorize the use of undercover investigators or of investigators that have real identity, with a view to identify offences, offenders and procure evidence; this article also contains provisions on the prosecutor's authority to promise, offer, or, as the case may be, to give money or other objects to a clerk, under the conditions provided by article 254, 256 or 257 of the Criminal Code, which incriminates bribery, the receiving of inappropriate goods or influence peddling, setting forth that the minutes conceived by undercover investigators or investigators with real identity and authorized by the provisions of the law can constitute evidence and can only be used in the criminal case which was authorized.

New procedural rules were introduced in the Romanian juridical system by Law no. 302/2004 concerning judicial international cooperation in criminal investigation matters, by the Government Emergency Ordinance no. 123/2007 concerning the measures adopted for consolidating judicial cooperation with the EU member states no. 123/2007^{lxxii}. These are influenced, as we shall see, by the transnational character of organized crime and they aim to obtain efficient ways for fighting against the new global criminal phenomena, since recent events in some member states require a strong and firm reaction on the part of Romanian authorities as well as in the domain of judicial cooperation and in criminal law matters. This refers to videoconference auditions (article 165) - subject to a procedure which observes the protection of witnesses, monitored deliveries (article 167) - as part of certain criminal procedures on offences that imply extradition, undercover investigations (article 168); at the same time the Romanian State can come to an agreement with a foreign state for offering mutual judicial assistance and for cancelling certain investigations by undercover agents, common inquiry teams (article 169), transborder surveillance (article 170), interception and recording of conversations (article 179) and the protection of witnesses (article 183), or, at the European Union level, by providing information about banking accounts (article 187¹¹),

banking operations (article 187¹²) and by the surveillance of banking transactions (article 187¹³), while specifying that bank secrecy can not be invoked as a refusal of cooperation when it comes to the assistance demands formulated by a EU member state, or when it comes to the dispositions concerning the facilitation for applying Decision no. 220/187/JAI of the European Union Council passed on 28th February 2002 on setting up Eurojust with a view to fight against grievous forms of criminality^{lxxiii}.

As one can deduce from the above simple enumeration of several procedures, the legislative reforms implemented in our country include judicial cooperation in criminal law matters, which has recently been radically modified by the rapid expansion of organized crime. Juridical assistance in criminal law matters makes use of the new special investigation techniques which should be applied to organized crime offences, at least if we refer to the hearing of suspects or witnesses which is accomplished by videoconferences or if we refer to the use of collaborators and undercover agencies as well as to the protection measures adopted for witnesses. Actually, we have the benefit – **de facto** – of applying several international cooperation means – in criminal law matters – which are provided by proactive inquiries and the special investigation techniques, and new criminal procedure rules - in which the law of the state is applied, and they represent clear instruments used in the fight against transnational organized crime. These are also reflected in the provisions of the Convention concluded on 29th May 2000 on mutual judicial assistance as to criminal law matters among the member states of the EU, to which Romania has recently adhered by the Decision of the Council no. 2007/63/CE on 8th November 2007^{lxxiv}.

These reforms have underlined the important transformations implemented in procedural law as a consequence of the appearance and development of grievous forms of criminality. As one can deduce from the presentation of the new laws that have been adopted to reinforce public security, legislative reforms enforced to fight against organized crime are doubled by the reforms adopted for criminal procedure whose aim is to confer more powers to the magistrates and policemen in such cases by setting up special bodies and by using new techniques in investigating evidence. Judicial practice in criminal law matters has played an important role in this reform, especially with the support of the High Court of Cassation and Justice^{lxxv}. Thus, the decisions reached by the High Court of Cassation and Justice, the Joint Sections – when trying appeals to the interest of law – clarify the most controversial legislative problems offering to the judges solutions meant to eliminate ambiguities give leeway to law texts, making them applicable, both in material law and in procedure. As a consequence of eliminating the recourse in cancellation by Law no. 576/2004, the practice of using recourses to the interest of law has developed considerably. This practice has recently enlarged its area of applicability by intervening – as it happens with the objections of unconstitutionality – in the most delicate problems of law, while finally bringing its contribution to the implementation of the legislative reform, including in the field of organized crime and terrorism. At the same time, an important contribution to the accomplishment of the legislative reform has been brought by the Constitutional Court especially as to its concrete, **a posteriori** control of constitutionality, which – according to article 146 in the Constitution and article 29 in Law no. 47/1992 on its organization and functioning – is enforced within a concrete criminal case, before the court of justice, in conformity with the ordinary procedural norms. After the law is published, the Court may be notified as to one objection of unconstitutionality (which may be invoked only in courts of justice in an on going criminal lawsuit, at any stage that lawsuit may be, until the criminal cause is completely solved), and also directly by the Advocate of the People^{lxxvi}.

All these laws - on reform of law to the interest of public security and the re-balance of the used procedures - have given birth to ample political or public debates. However, reforms are far from being accomplished. They reflect the regulator's vision as to his efforts

to reinforce the procedural means necessary for reprimanding the grievous forms of criminality. However, this implies the continuation of these efforts so that such infractional phenomena could be prevented. That is why, such reform provisions are being adopted gradually, and some of them are even publicly debated. In this respect, the project of a new Code of Criminal Procedure has priority and its accomplishment is an on going process, submitted to debates to the interested persons, as well as to public debates organized by the Ministry of Justice. The project of the new Code of Criminal Procedure contains a distinct chapter, in the special part, on the special surveillance or research techniques, which are used for the interception of conversations. These techniques are: the use of video and audio monitoring, taking photographs in private or public spaces, locating or following by GPS or other technical surveillance means, monitoring telephone conversations, retaining, sending or searching mail, collecting, in real time, the data sent by communication means, monitoring financial transactions and disclosing financial data, using undercover investigators, simulating corruption offences or concluding a convention, monitored delivery and identifying the subscriber, owner or user of a telecommunication system or of an access point to a computer. At the same time the bill for altering and completing Law no. 47/1992 - on the organization and functioning of the Constitutional Court - is still publicly debated; the main provision of the project consists in eliminating the lawful cancellation of the judgment in case the objection of unconstitutionality is invoked. According to this bill the judge is to pass the disposition of judgment cancellation. Thus, this future regulation aims to avoid the delay of the judgment on the grounds of objection of unconstitutionality, which is a frequent tactic used in the present judicial practice, especially in those cases that try grievous criminal offences. The bill for altering and completing Law no. 656/2002 – on preventing and deterring money laundry, as well as on implementing measures for preventing and fighting against financing acts of terrorism – is also publicly debated. By means of this bill, a new measure has been adopted, which is subject to the prosecutor’s authorization, according to a special procedure, namely monitored delivery of money, new regulations on the bank secrecy and the professional secret, as well as the adoption of restraint measures as to the goods that are the object of the money laundry offence or of the financing sources used to support acts of terrorism. This bill provides an impunity cause for the offender who participates to the committal of an offence but who denounces and facilitates the identification and sanctioning of other offenders during the criminal investigation.

SECTION II

General Questions on criminal proceedings and special measures

4. What are the general principles of your criminal procedure (e.g., principle of legality, fair justice, and equality of arms) and what is their legal source (e.g., constitution, statute)?

The procedure adopted in criminal cases in Romania is governed by a series of fundamental principles that are set forth exclusively in the Constitution of Romania^{lxxvii}, or both in the Constitution of Romania and in the Code of Criminal Procedure, or only in the Code of Criminal Procedure. A series of these basic rules that govern the criminal trial are also set forth in Law no. 304/2004 on the organization of the judiciary^{lxxviii}.

In the first category, the one including the fundamental principles set forth exclusively in the text of the Romanian Constitution, there is included:

- equality of rights

This principle is set forth in article 16 of the Constitution. According to this principle, all citizens are equal before the law and public authorities, without any privilege or discrimination, since no one is above the law. At the same time, in conformity with article

124. (2) of the Constitution, justice shall be one, impartial and equal for all. At the same time, in conformity with the provisions of Law no. 304/2004 on the organization of the judiciary, justice shall be done according to the law, it is unique, impartial and equal for all (article 2. (1)); all citizens are equal before the law, without any privilege or discrimination (article 7. (1)); justice is done equally to all people, no matter what race, nationality, ethnical origin, language, religion, sex, sexual orientation, opinion, political orientation, fortune, origin or social condition someone may have or no matter what discriminating argument may be brought in discussion (article 7. (2)).

- free access to justice

This principle is regulated in article 21 (1) and (2) in the Constitution of Romania, in conformity with which any person is entitled to bring cases before the courts for the defence of his legitimate rights, liberties and interests; the exercise of this right shall not be restricted by any law.

According to article 6 of the Law no. 304/2004 on the organization of the judiciary, any person can bring a case before courts to defend his legitimate rights, liberties and interests in exercising his right to a fair trial. Access to justice shall not be restricted in any way.

- the right to a fair trial

This regulation is provided in article 21. (3) of the Constitution, according to which all parties shall be entitled to a fair trial and a solution of their cases within a reasonable term.

According to article 10 of the Law no. 304/2004 on the organization of the judiciary, all persons are entitled to a fair trial and a solution of their cases within a reasonable term, by an impartial, independent and legally constituted court of justice.

- inviolability of domicile and correspondence

Inviolability of domicile is stipulated in article 27 of the Romanian Constitution. According to the constitutional principle set forth in this article, no one shall enter or remain in the domicile or residence of a person without his consent. At the same time, there is an exemption from the provisions of this article – concerning inviolability of domicile – which can operate for the following 4 instances: a) carrying into execution a warrant for arrest or a court decree; b) removing a risk to someone's life, physical integrity, or a person's assets; c) defending national security or public order; d) preventing the spread of an epidemic. The constitutional norms also stipulate – with reference to the same principle of inviolability of domicile - that searches shall only be ordered by a judge and carried out under the terms and forms stipulated by the Code of Criminal Procedure. At the same time, according to the same article of the Constitution, searches during the night shall be forbidden, except for crimes in flagrante delicto (article 27. (4)).

This constitutional norm is also guaranteed by the criminal law on the violation of domicile (article 192 the Romanian Criminal Code).

Secrecy of correspondence is stipulated in article 28, according to which secrecy of the letters, telegrams and other postal communications, of telephone conversations, and of any other legal means of communication is inviolable.

This constitutional norm is also guaranteed by the criminal law on the violation of secrecy of correspondence (article 195 the Romanian Criminal Code).

- right of a person aggrieved by a public authority as a result of a judicial error

This constitutional principle refers to any person who was aggrieved in his/her legitimate rights or interests by a public authority as a result of a judicial error. In other words, one can not talk about a fundamental principle of the criminal case, but rather about a rule which is applicable after the trial and is interconnected with criminal procedure. Thus, according to article 52. (3) of the Romanian Constitution, the State shall bear patrimony liability for any prejudice caused as a result of judicial errors. The State liability shall be

assessed according to the law and shall not eliminate the liability of the magistrates having exercised their mandate in ill will or grave negligence.

This constitutional norm is also guaranteed by the implementation of a procedure on damage repair necessary to compensate an unjust conviction or unlawful liberty restraint or unlawful preventative measure (article 504-507 the Code of Criminal Procedure).

From the second category of fundamental principles – the ones stipulated both in the Constitution of Romania and in the Code of Criminal Procedure – we mention: the principle of legality, individual freedom, presumption of innocence, right to defence, legal procedure conducted in Romanian, use of interpreter in court.

- the principle of legality

Supremacy of law – according to which in Romania, the observance of the Constitution, its supremacy and the laws shall be mandatory – is stipulated in article 1. (5) of the Romanian Constitution. According to article 2. (1), the Code of Criminal Procedure, the criminal trial takes place both during the criminal investigation and the trial itself, according to the provisions of the law.

We consider relevant to mention, in this respect, the provisions of article 3 of the Law no. 304/2004 on the organization of the judiciary, according to which the competence of judicial bodies and judicial practice shall be established in conformity with the provisions of law.

The principle of legality with reference to criminal trial is doubled by a large number of guarantees; thus, any violation of legal provisions entails the nullity of the act (according to article 197. (1), the Code of Criminal Procedure), and when the violation of the legal provisions is inexcusable, the nullity stipulated in paragraph 2 cannot be suspended in any way (article 197 (2), the Code of Criminal Procedure). Besides the criminal procedural sanctions applicable to the procesual and procedural acts that represent a violation of law, there is a series of sanctions applicable to the persons that infringed the law when performing procesual criminal acts. These sanctions can be administrative, civil or criminal. With a view to reinforce the principle of legality in the criminal trial, besides procedural sanctions, administrative, civil or criminal sanctions, which are applied according to the seriousness of the infringement, there are numerous possibilities of systematic and efficient control by which procesual and procedural unlawful acts are identified and removed. Thus, the whole criminal investigation enforced by judicial police bodies is supervised by the prosecutor (according to article 216-220 the Code of Criminal Procedure).

- individual freedom

This principle is thoroughly regulated in article 23 of the Romanian Constitution; from the regulations stipulated in article 23 we can mention: individual freedom and security of a person are inviolable; Search, detainment, or arrest of a person shall be permitted only in the cases and under the procedure provided by law; preventive custody shall be ordered by a judge and only in the course of criminal proceedings; the release of a detained or arrested person shall be mandatory if the reasons for such steps have ceased to exist, as well as under other circumstances stipulated by the law; any person detained or arrested shall be promptly informed, in a language he understands, of the grounds for his detention or arrest; a person under preventive custody shall have the right to apply for provisional release, under judicial control or on bail etc.

This basic principle applied in a criminal trial is also stipulated in article 5 the Code of Criminal Procedure. Thus, in conformity with this text, the person's liberty is guaranteed all throughout the criminal trial, no person can be retained or subjected to any form of liberty restraint, except for the cases and circumstances stipulated by the law.

- presumption of innocence

According to article 23. (11) of the Romanian Constitution, any person shall be presumed innocent till found guilty by a final decision of the court. This principle is also stipulated in article 5² of the Code of Criminal Procedure, according to which any person shall be presumed innocent till found guilty by a final decision.

- right to defence

This principle is stipulated in article 24 of the Romanian Constitution, according to which the right to defence is guaranteed, and the parties shall have the right to be assisted by a lawyer of their own choosing or appointed ex officio. This principle is also stipulated in article 6 of the Code of Criminal Procedure, respectively in the provisions of article 15 of Law no. 304/2004 on the organization of the judiciary.

In Romanian^{lxxix} criminal procesual doctrine one can notice that right to defence implies new procesual aspects as follows: a) the judicial bodies are bound to inform the defendant, before he/she makes the first statement, about his/her right to be assisted by a lawyer; this acknowledgement shall be mentioned in the hearing minutes; b) the obligation of the judicial bodies – regarded as a fundamental principle – to ensure judicial assistance to the defendant, when he does not have anyone to represent him/her in court; c) the obligation of the judicial bodies – regarded as a fundamental principle – to inform the defendant immediately and before hearing him/her as to the deed for which he/she is investigated, also showing him the judicial framing of the deed committed^{lxxx}; d) the obligation of the judicial bodies – regarded as a fundamental principle – to gather all the necessary evidence both in favour and in the detriment of the defendant (article 202. 1, the Code of Criminal Procedure).

- the language in which legal procedure is conducted; the use of interpreter in court is guaranteed.

According to article 128. (1) in the Constitution of Romania, judicial procedure shall be conducted in Romanian. At the same time, Romanian citizens belonging to national minorities have the right to express themselves in their mother tongue before the courts of law, under the terms of the organic law (article 128. (2)). These constitutional provisions are also stipulated in the Code of Criminal Procedure (article 7), respectively in Law no. 304/2004 on the organization of the judiciary.

Foreign citizens and stateless persons who do not understand or do not speak the Romanian language shall be entitled to take cognizance of all the file papers and proceedings, to speak in court and draw conclusions, by means of an interpreter; in criminal law suits, this right is ensured free of charge (article 128. (4) of the Romanian Constitution). This regulation is detailed in article 8 of the Code of Criminal Procedure, according to which the parties who do not speak the language used in the criminal trial are given the possibility to get acquainted with the record, to speak in court and pass conclusions through an interpreter.

At the same time, similar provisions are stipulated in article 14 of the Law no. 304/2004 on the organization of the judiciary.

From the third category of fundamental principles exclusively stipulated in the Code of Criminal Procedure, we mention: the principle of officiality, the principle of finding the truth, the principle of the active role, the principle of human dignity.

- ex officio procedure

According to this fundamental principle, the papers necessary for the criminal trial are drawn up ex officio, if the law does not stipulate otherwise (article 2. (2), the Code of Criminal Procedure). Thus, according to article 228 in the Code of Criminal Procedure - when the criminal investigation body is informed ex officio - it draws up an official report that constitutes the act of initiation of the criminal investigation; according to article 232 in the Code of Criminal Procedure, the criminal investigation bodies are bound to draw up the papers necessary for the criminal trial; in conformity with article 232, the Code of Criminal Procedure, the criminal investigation bodies are bound to perform criminal investigation acts;

according to article 262, the Code of Criminal Procedure, the prosecutor is bound to bring a case against the defendant if the legal conditions for doing this are met. The obligations that lie with the instance in the trial instance stage are stipulated by article 313, the Code of Criminal Procedure, according to which the instance is bound to adopt preliminary measures before the trial, as well as article 321, 322, 323 and 324 of the Code of Criminal Procedure – relative to the clarification, demands and the exceptions (that the president of the instance requires), the order of the judicial research, the hearing of the defendant and co-defendants, article 345 and 346, the Code of Criminal Procedure – relative to the obligation of the instance to pronounce, according to case, the conviction, acquittal or cessation of the criminal trial etc. The enforcement of the decision is provided in article 418, the Code of Criminal Procedure, according to which once declared final the decision of the criminal court is enforced by the first court of trial.

- the disclosure of the truth

This principle stipulates that the criminal trial must lead to the disclosure of the truth regarding the deeds and circumstances of the cause, as well as those regarding the perpetrator (article 3, the Code of Criminal Procedure);

- the principle according to which criminal investigation bodies and courts must take active part in the criminal trial is stipulated in article 4, the Code of Criminal Procedure;

- the principle according to which any person subjected to criminal investigation or to criminal trial must be treated with respect is stipulated in article 5¹, the Code of Criminal Procedure.

Last but not least, we insist on the fact that - in Romanian^{lxxxii} criminal procesual doctrine - the principle of operativity in the criminal trial is unanimously recognized, even if this is not particularly used. Yet, the urge to inform in due time and completely the deeds that represent crimes at the end of a criminal trial is to be deduced from all the procesual criminal dispositions.

5. At what stage(s) of the criminal process does your legal system provide for the presumption of innocence and the right of the suspect/accused to remain silent?

According to article 5² in the Code of Criminal Procedure, the presumption of innocence can be invoked until the guilt is proved. Guilt is sanctioned by a final court decision. This provision is doubled by a constitutional norm (article 23. 11 of the Romanian Constitution).

Criminal processual legislation of Romania has been adnotated in the sense that the defendant has the right to remain silent. In this respect, according to article 70. (2) in the Code of Criminal Procedure, altered by Law no. 281/2003, the defendant – before being heard – is informed about the deed that makes the object of the cause, his right to have a lawyer, as well as his right to remain silent, being seriously warned that anything he declares can be used against him in court. Subsequently, by Law no. 356/2006^{lxxxiii}, this law was adnotated to include the obligation of the judicial bodies to inform the defendant as far as the judicial framing of the deed committed is concerned.

The text explicitly points out that the criminal investigation bodies are bound to inform the defendant of the deed which makes the object of the investigation before the defendant is asked to make the first statement. The procedure is applied only before the first statement is made, which means that for any further statements the defendant is not to be reformed as to his right to be defended by a lawyer and the object of the investigation.

However, the Romanian regulator has established that this procedure should be also applied at the stage of the judicial investigation, before the defendant is asked to make his/her first statement. In this respect, article 322. (1) of the Code of Criminal Procedure has been modified by Law no. 356/2006, and it has the following contents: The President ... explains

to the defendant the blame for which he is made responsible ... he also informs the defendant as to his right to remain silent, warning him that anything he says may be used against him, as well as to his right to ask the co-defendants, the other parties, the witnesses and experts questions, as well as to give explanations whenever he thinks necessary during the judicial investigation^{lxxxiii}. Under these conditions, we consider that the present processual framework in Romania is attentively regulates the defendant's right to remain silent. In consequence, there are two stages in which the judicial body is obliged to inform the defendant about this right, namely: before he is asked to make the first statement, by the criminal investigation bodies, and before he makes his first statement during the judicial investigation.

6. Does your common criminal procedure or special proceedings provide for a distinction between citizens and non-citizens, nationals or non-nationals, or specific categories of subjects (aliens, enemies, non-persons)?

In general, our criminal procedure, no matter if it is ordinary or special, does not make differences between persons, its fundamental principle being the equality of rights for all citizens, as stipulated in article 16. (1), 16. (2) and in article 21 of the Romanian Constitution. According to article 16, "citizens are equal before the law and public authorities, without any privilege or discrimination" and "No one is above the law". According to article 21, "every person is entitled to bring cases before the courts for the defence of his legitimate rights, liberties and interests", and no law can cancel the exercise of this right^{lxxxiv}. Finally, article 21 also provides that "all parties shall be entitled to a fair trial ...". These constitutional principles represent a particular application of the principle stipulated in article 4 of the Romanian Constitution – equality of all citizens – which is the solemn expression of article 1 of the Universal Declaration of Human Rights: "All human beings are born free and equal in dignity and rights". As to the aliens and stateless persons who live in Romania, article 18. (1) of the Constitution stipulates that they shall enjoy general protection of persons and assets, as guaranteed by the Constitution and other laws.

This principle, which basically provides that similar situations require a similar juridical approach, is also regulated in article 7 of the Law 304/2004, according to which "all persons are equal before the law, without any privilege or discrimination", and justice "shall be equally applied for all no matter the race, nationality, ethnical origin, language, religion, sex, sexual orientation, opinion, political orientation, fortune, origin or social condition or any other discriminatory criteria^{lxxxv}". Similarly, in conformity with article 10 of the Law no. 304/2004 "all persons shall be entitled to a fair trial..." These regulations reinforce the principle stipulated in article 14 of the Strasbourg Convention, according to which the exercise of the rights and freedoms provided by the Convention shall be ensured, without discrimination based on sex, race, skin colour, language, religion, political orientation, national or social origin, ethnical origin, fortune, birth or any other criterion^{lxxxvi}.

Traditionally, in criminal procedure the principle of equality of persons is represented as an equality of arms (*l'egalite des armes*^{lxxxvii}). However, the Constitution of Romania does not explicitly stipulate such a rule, but in conformity with article (11) and article 20 of the Constitution this principle is referred to since the provisions of article 6 (1) of the European Convention of Human Rights have been integrated in the sphere of constitutional norms relative to the protection of the fundamental rights, which explicitly refer to this principle, as to one of the equity principles which one should take into consideration in a criminal lawsuit^{lxxxviii}.

In conformity with this principle, as it is stipulated in article 6 (1) of the European Convention, and taking into consideration the way it has been developed in the European Court of Human Rights case law, every party in the trial is entitled to equal chances in

pleading for its cause, from all points of view, while it is not permitted for anyone to benefit of any advantage over his opponent^{lxxxix}.

Thus, equality of the persons - that are parties in a criminal trial - means that the same processual rules are applied to all the people and that the same bodies are involved in the criminal trial, without any discrimination and without any privilege for anyone. From this point of view, in a present instance^{xc}, presented to the Constitutional Court as an instance of unconstitutionality, the parties invoked the fact that article 128 of the Constitution (currently article 129) "stipulates the equality of the participants in a trial, which does not mean that the recourse in cancellation exclusively depends on the General Public Prosecutor"^{xcⁱ}. The Constitutional Court appreciated, however, that this is an extremely reductionist perspective, which alters the meaning of the constitutional provisions stipulated in article 16 and article 128. The sintagm "under the terms of law" from article 128 of the Constitution can not have the meaning indicated by the authors of the objection of unconstitutionality, namely that the parties in the juridical system are bound to adopt the same attitude as in the ways of attack conferred by law against judicial decisions. It has also been pointed out the fact that the meaning of the concept of fair trial as it appears in the European Convention of the human rights does not necessarily imply more levels of jurisdiction, nor the possibility to exercise ways of attack, including extraordinary ones, against all judicial decisions, so that the equality of arms could not be invoked. There is an opposite approach which stands with the authors' of the objection of unconstitutionality principle and it reveals that the principle of equality of arms requires an identical treatment between the Public Ministry and the parties in a trial. The whole regulations concerning the ways of attack stipulated in the Code of Criminal Procedure revealed an ostentative inequality.

The Constitutional Court has decided that the disposition included in article 254 (1), the Code of Criminal Procedure, which conditioned the presentation of the criminal investigation material on the defendant's living in the country^{xcⁱⁱ}, contravenes with article 16 of the Constitution, which stipulated the citizens' equality of rights, since it discriminates the persons who live in the country and the ones who live abroad or temporarily stay in a foreign country, but who are investigated in Romania for having committed offences. The persons who temporarily stay in a foreign country do not benefit of all the processual guarantees provided by the law^{xcⁱⁱⁱ}. In the Constitutional Court case law it has been constantly decided that the principle of equality before law means adopting an equal approach for situations which, according to their aim, are not different. The Court appreciates that "the persons who live in Romania and the ones who live abroad are not in different situations that might justify a different approach of the legal matter, so that the criticized legal text disobeys the provisions of article 16"^{xc^{iv}}. Consequently, the Court points out the fact that the criminal investigation body, after initiating the criminal action, if all the necessary acts for the criminal investigation have been prepared, is bound to call the defendant who is not in the country to present him the criminal investigation material, after which the dispositions of article 250-254 from the Code of Criminal Procedure^{xc^v} are to be implemented.

We underline the fact that, in similar circumstances, the Constitutional Court has also considered as unconstitutional those dispositions which, in one way or another, block the complete exercise of the right to defence which the defendant is entitled to, especially if the defendant is not informed of the object of the criminal investigation, thus, creating a state of unjustified inequality in the judicial treatment of the defendant. According to Decision no. 24/1999^{xc^{vi}} the Court admits the exception of unconstitutionality - stipulated in article 257 in the Code of Criminal Procedure and altered today by Law no. 281/2003 - pointing out that the sintagm "if it finds necessary" is unconstitutional, since it creates the possibility of initiating a criminal investigation against defendant who has not been informed of the object of the

criminal investigation, for the simple reason that the prosecutor considered unnecessary to call him and inform him of the object of the criminal investigation.

At the same time, both in ordinary criminal procedure and in several special criminal procedures there are competence rules established according to the quality of the person^{xcvii}, such as the quality of a soldier, of an employee in the judicial system, of a Member of Parliament etc., quality which requires different competences. Thus, competence of criminal investigation bodies is regulated (article 208 in the Code of Criminal Procedure), competence of the prosecutor (article 209. (3), the Code of Criminal Procedure), competence of the court of justice (article 27 in the Law no. 218/2002), competence of the military court (article 26. (1), let. a, the Code of Criminal Procedure), competence of the court of appeal (article 28¹ let. b, c, the Code of Criminal Procedure), competence of the Military Court of Appeal (article 28², the Code of Criminal Procedure) and competence of the High Court of Cassation and Justice (article 29, the Code of Criminal Procedure). Competence according to the quality of the person, as it is regulated by the Code of Criminal Procedure, does not represent an exception from the principle of the person's equality in the criminal trial, since it does not justify a difference to be made between specific categories of subjects in approaching an ordinary criminal procedure. The same thing may be said, in principle, also with reference to the special procedures provided in the Code of Criminal Procedure, for the criminal investigation procedure and the judgment procedure of juveniles (article 480-493, Code of Criminal Procedure), for neither the competence nor the application of a procedural rule under these circumstances is not discriminatory.

However, not the same thing can be said as to the competence by the quality of the person stipulated by the Government Emergency Ordinance number 43/2002 on NAD, with its subsequent adnotations and modifications, which, in article 13 let. (b), which conditions NAD competence as to the offences stipulated by Law no. 78/2000, with its subsequent modifications and adnotations, on certain qualities of the offender, no matter what damage he created or the breach of peace he provoked to public institutions or any other employee in the judicial system, no matter the sum of money or the values of the good which represents the object of the offence. By means of this regulation, the special competence of a judicial body specialized in preventing and fighting against corruption offences is doubled by a competence imposed by the person's quality. This generates the risk of creating an inadmissible inequality since a fair trial should guarantee a fair trial between the subjects implied in the offence. The difference made as to the problem of competence also generates a different procedural approach here, susceptible to seriously aggrieve the individual rights and freedoms by authorizing the use of special procedural means. However, such a situation can not be found in case of the offenders involved in organized crime and terrorism acts which come in the competence of DIOCTO, according to Law no. 508/2004 (article 12), for in this situation, the competence of the specialized judicial body is not determined according to the person's quality, and the unique criterion used by the regulator is the one represented by the seriousness of the committed offences.

7. Does your legal system allow for the suspension of human rights in emergency situations (including war)?

An emergency state is mentioned, besides the state of siege, in the Constitution, justifying a special procedure to be applied, which reveals the Romanian President's competence, as well as the competence of Parliament, in article 93. A similar procedure is also provided for warfare situations (article 65). Government Emergency Ordinance number 1/1999 on the state of siege and the state of emergency^{xcviii} as well as the Law number 453/2004^{xcix} do not include provisions that authorize the suspension of human rights in emergency situations. On the contrary, article 3² of the Government Emergency Ordinance

no. 1/1999 (introduced by Law no. 453/2004) provides that - as long as the emergency state lasts - torture, inhuman and degrading punishments and treatment, as well as constraint of free access to justice, shall be prohibited. Our juridical system does not recognize the distinction between derogatory and nonderogatory human rights. Article 4 of the Government Emergency Ordinance number 1/1999 (which was altered by the Law no. 453/2004) provides that during wartime the exercise of several fundamental rights and freedoms can be restricted, except the human rights and fundamental freedoms provided in article 3². This restriction is possible only if the situation requires this and in conformity with the provisions of article 53 of the Romanian Constitution, in the republished edition^c.

As to these legal provisions, which have the statute of principles, the Romanian regulator recognizes two categories of rights and freedoms that can not be restricted according to article 53 of the Constitution. The two categories are: the observance of the human dignity, consisting of the interdiction of torture, punishments or inhuman or degrading treatment and free access to justice. As far as all the other rights and freedoms are concerned, they can be restricted, but only if it is absolutely necessary, respectively, in conformity with the legal provisions in force – “only if necessary and as the case may be” – and in conformity with the above mentioned provisions of article 53 of the Constitution. Such provisions, which have a general character, are not sufficient for the authorization of criminal provisions derogatory from the ordinary criminal procedure because the Code of Criminal Procedure and the special laws do not provide exceptional procedural rules that could be justified by an emergency state, as an exigency of the principle of strict lawfulness which governs the criminal trial.

The criminal trial in Romania does not include military procedures derogatory from the ordinary criminal procedural principles. There is an exception and that is regulated in the Criminal Code, according to which for certain types of offences committed against Romania’s^{ci} capacity to defend itself, it is necessary to notify the commanding officer with a view to enforce the procedure for grounding criminal liability. The Code of Criminal Procedure also provides norms that are applicable to the military staff, but they can not be regarded as norms derogatory from ordinary procedure^{cii}.

Special criminal procedures that can be applied in the criminal trial in Romania are regulated either by the Code of Criminal Procedures (criminal investigation procedure, the procedure used in criminal trials for flagrant offences, criminal juvenile procedure, the procedure used in the initiation of a criminal investigation, rehabilitation procedure etc.), or by special laws (international judicial cooperation procedures in criminal law, regulated by Law no. 302/2004 on international judicial cooperation for criminal matters^{ciii}). This procedure provides both the application of norms specific for ordinary procedure and derogatory norms.

8. Does your legal system allow for the use of intelligence information (e.g., general police intelligence, national or foreign intelligence services information) in criminal proceedings?

The national juridical system provides the possibility of using intelligence information for initiating criminal investigation.

Thus, in conformity with article 224 (2), the Code of Criminal Procedure, in order to collect evidence for initiating the criminal investigation, the operative employees of the Ministry of Internal Affairs may perform preliminary acts. The preliminary acts mainly consist of police operations such as operative investigations, gathering information and data, organizing raids, police filters etc. Other preliminary acts are: the interception and recording of conversations – including the conversations made by phone or other electronic means, according to the provisions of the article 91¹-91⁶ of the Code of Criminal Procedure.

Undercover investigators may also be used for accomplishing the preliminary acts as article 224¹-224⁴ from the Code of Criminal Procedure^{civ} provides. Thus, investigators with a false identity may be used for gathering evidence to prove the existence the offence and to identify the offenders, if there are serious and concrete grounds that reveal the committal of an offence or the intention to commit an offence which threatens national security. This possibility is provided in Criminal Code and in special laws. Undercover investigators may also be used for drug trafficking and gun dealing, traffic with persons, acts of terrorism, money laundry, forgery of coins or other values, of for an offence provided by the Law no. 78/2000 on preventing, identifying and sanctioning corruption acts, with its subsequent adnotations and modifications, or for another grievous offence which can not be identified or whose offenders can not be identified by other means. These undercover investigators can be used for an utmost period of 60 days, period which can be prolonged for seriously justified grounds. Every prolongation can not be longer that 30 days, and the whole duration of the authorization, in the same cause and with reference to the same person, can not be longer than a year. The undercover investigator's activity is performed on the basis of an authorization issued by a justified ordinance by the prosecutor who is responsible with the criminal prosecution and its monitoring. The data and information gathered will be handed in to the prosecutor.

As to the intelligence officers, according to article 224. (2) from the Code of Criminal Procedure, preliminary acts may be performed by the employees from the state bodies having attributions related to national security, for the deeds that constitute, according to the law, threats to the national security. In this situation, the gathering of evidence is supervised by the prosecutor. In this respect, we mention the provisions of article 66. (2) from the Law no. 304/2004 on the organization of the judiciary, according to which the services and bodies specialized in gathering, processing and archiving the information are bound to immediately present to the competent Public Prosecutor's Office all the data and information unprocessed and possessed as to the committal of the offence. In this respect, we also refer to the provisions of article 13 from the Law no. 51/1991 on the national security of Romania^{cv}, according to which the gathering of information for national security is the prosecutor's responsibility.

During the criminal trial, coercitive processual measures (preventing measures, assurance measures) or probatory acts (that imply restraining certain fundamental rights and freedoms - interception and audio or video recordings, intercepting correspondence, and domicile search) may be adopted. All this set of activities may be performed only with the magistrate's consent (basically, the law provides as necessary a judicial disposition), disposition which can be grounded on the data and information obtained from the police employees or the intelligence officers.

Within the procedure used in the criminal prosecution, there is a disposition which provides the bringing to court of all the persons against whom there are solid grounds and evidence proving their committal of an offence. These data and information may be obtained from policemen or intelligence officers, in conformity with the provisions of the law.

SECTION III

Pro-active enforcement (common police or common criminal proceedings, special proceedings)

9. Do intelligence forces, regular police forces, or administrative enforcement agencies (such as customs or tax agencies) have the competence in your country to use coercive powers in a pro-active way?

In the criminal proceedings performed in Romania personal or real coercive processual measures may be used, by means of which individual freedom, the freedom of movement, patrimonial rights may be aggrieved. At the same time, some probatory methods may aggrieve the right to the inviolability of the domicile and the secrecy of correspondence. In this respect, we distinguish:

- detainment

The disposition for detaining the defendant during the criminal prosecution, for 24 hours the most may be given by the judicial police or the prosecutor.

- the obligation not to live the locality and not to leave the country

During the criminal prosecution, these measures may be adopted against the defendant for a maximum term of 2 years, by the prosecutor or the court of justice. All throughout the criminal trial, these measures are adopted by the court of justice, and the law does not specify a maximum duration.

- preventive arrest

The measure of preventive arrest may be decided only by a judge and for a maximum term of 180 days during the criminal prosecution. All throughout the criminal trial, preventive arrest may be decided by the court of justice for a term that is no longer than half of the maximum punishment provided by the law on the offence which represents the object of the accusation.

- temporary release under judicial control or on bail

Temporary release may be approved as long as the criminal trial lasts by the court of justice. The adoption of this measure implies a coercitive surveillance of the defendant.

- medical internment and obligatory medical treatment

The safety medical measures may be adopted in conformity with the provisions of the law only by the instance, no matter what processual stage the trial is.

- the seizure of the goods

Assurance measures may be adopted during the criminal prosecution by a prosecutor and during the trial by the instance and they consist of seizing the mobile or imobile goods of the defendant or the civilly liable person.

- intercepting and audio or video recording

Intercepting and recording of conversations – made by phone or any other electronic means of communication – is accomplished with judicial grounded authorization, at the request of the prosecutor who is in charge with the supervision of the criminal prosecution, in accordance with the conditions provided by law, if there are data or solid grounds concerning the intention to commit or the committal of an offence for which the criminal prosecution is performed ex officio, and the interception and recording are obligatory for establishing the situation de facto or because the identification or location of the offenders can not be made by other means or because the investigation would be too much delayed (article 91¹. (1), the Code of Criminal Procedure). For exceptional situations, when the procurator of the judge's authorization could cause serious prejudices to the criminal prosecution, the prosecutor in charge with the criminal prosecution may dispose, provisorily, by motivated ordinance, the interception and recording of conversations for a maximum duration of 48 hours.

- retention and delivery of correspondence

The instance, at the prosecutor's request, while the criminal prosecution goes on, or ex officio, during the trial, may dispose that every postal office or transport company should retain and deliver letters, telegrams and any other correspondence, or the object sent by the offender, or the object addressed to him, either directly, or indirectly, on condition that there are data or solid grounds concerning the intention of committing an offence or concerning the committal of an offence for which criminal prosecution is enforced ex officio, and the retention and delivery are necessary for clarifying the situation de facto or because the

identification or localization of the participants may not be performed by other means or if the investigation could be too much delayed (article 98, the Code of Criminal Procedure). Retention and delivery of letters, telegrams and any other correspondence or of the objects sent by the defendant, or addressed to him, either directly, or indirectly, may be disposed, in writing, in cases of emergency and if there are solid grounds justified by the prosecutor, who is bound to announce the instance about this immediately.

- domicile search

Domicile search may be disposed only by the judge, by a motivated decision, during the criminal prosecution, at the prosecutor's request, or during the trial, if the person who was asked to deliver an object or the writings mentioned in article 98 of the Code of Criminal Procedure denies their existence or possession, as well as whenever it is necessary in order to discover and gather evidence (article 100 from the Code of Criminal Procedure).

These legal provisions point out the fact that during the criminal trial, in Romania, intelligence services or other public administrative authorities (customs and tax bodies) may not adopt measures that would restrain the fundamental rights and freedoms of the citizens.

The most delicate aspects concerning the problem of evidence in the fight against serious criminality focuses on the techniques used for investigating the evidence and, in this respect, the main problem remains the inviolability of the secrecy phone conversations and of other communication means. In this respect, it is relevant the fact that besides the provisions from the Code of Criminal Procedure, there are special criminal processual regulations on audio or video recordings, as to the prevention and fight against drug dealing (article 23 of the Law no. 143/2000), traffic of persons (article 23 of the Law no. 678/2001), money laundry and the prevention of financing terrorism acts (article 27 of the Law no. 656/2002), computer criminality (article 57 of the Law no. 161/2003), organized crime (article 15 of the Law no. 39/2003 and article 16 of the Law no. 508/2004), terrorism (articles 20-22 of the Law no. 535/2004) and corruption (article 16 of the Government Emergency Ordinance no. 43/2002), special laws that either include dispositions derogatory from the code, or refer to the appropriate application of the provisions stipulated by the Code of Criminal Procedure.

As to the probatory rules on bank secrecy and the professional secret, there are special regulations for organized crime, terrorism and corruption. Thus, there is a procedure for the supervision of the banking accounts and of the accounts assimilated to them (article 15 let. (a) of the Law no. 39/2003, article 27 of the Law no. 656/2002, article 15 of the Law no. 508/2004, article 27 of the Law no. 78/2000 for preventing, identifying and sanctioning corruption acts^{cvi} and article 16 of the Government Emergency Ordinance 43/2002). Similarly, it is generally provided that as to the serious offences - like organized crime, terrorism or corruption acts - the bank secrecy and the professional secret, except the lawyer's professional secret, are not opposable to the prosecutor, after the criminal investigation is enforced and nor to the court of justice. The data and information may be required in writing by the prosecutor during the criminal prosecution, on the basis of the motivated authorization of the prosecutor appointed by the General Public Prosecutor of the Public Prosecutor's Office attached to the Court of Appeal, and during the trial by the instance (article 14 of the Law no. 39/2003). The regulation is stricter for money laundry or for the financing of terrorism acts for which it is provided that bank secrecy and the professional secret, including the professional secret of the lawyer, are not opposable to the criminal investigation bodies in all instances or to the courts of justice. The data and information are sent at the written request of the prosecutor or of the criminal investigation bodies, if their request has been authorized by the prosecutor or by the courts of justice.

Among the techniques known as "proactive investigation", one can bring into evidence surveilled delivery, for which a special procedure is provided in the laws on organized crime and terrorism (article 20 of the Law no. 143/2000, article 16 of the Law no.

39/2003 and article 18 of the Law no. 508/2004). Recently, by the Government Emergency Ordinance no. 53/2008^{cvi}, such a technique, consisting of "surveilled money delivery" has also been introduced in article 27 of the Law no. 656/2002 for money laundry and the financing of terrorism acts, stipulating that this measure can be adopted by the prosecutor and it is authorized by a motivated ordinance, which must include the solid grounds for justifying the reasons for which the measure must be adopted, the details about the money that make the object of the surveilled delivery, the place where and the time when the delivery takes place or, as the case may be, the itinerary which is to be covered to make the delivery, if they are known, and the identification data of the persons authorized to supervise the delivery.

10. Does your legal system allow for the use of tough forms of investigation techniques (torture or cruel, unusual, or inhuman treatment) during pro-active enforcement, and, if yes, under which conditions?

According to article 5¹ from the Code of Criminal Procedure, any person who is the subject of a criminal prosecution or who is involved in a trial must be treated respectfully, not to aggrieve his/her human dignity. The use of torture or of other cruel, inhuman or degrading treatments is punished in conformity with the law. In this respect, we mention the provisions of article 267¹ from the Code of Criminal Procedure. According to this article, the deed which intentionally causes a person pain or strong physical or psychic sufferance (especially with the intention to obtain from this person or from another person information or confessions, or with the intention to punish him/her for an act committed or supposed to have been committed by this person or a third one, with a view to intimidate or to put pressure on him/her or to intimidate or to put pressure on a third person, or for any other reason which proves to be an act of discrimination), then when such a pain or sufferance are applied by an agent of the public authorities or by any other person who acts officially or agrees to act in this way at the urge of a public authorities employee, we can speak about torture and this is punishable with imprisonment from 2 to 7 years. This article also mentions that no exceptional circumstance, no matter what that may be – a state of war or a war threat, political internal instability or any other exceptional state – may be invoked to justify torture. At the same time, the superior's order or any other public authority's order may not be invoked in this respect.

It is necessary to mention the provisions of article 68 (1) from the Code of Criminal Procedure, according to which violence, threat or any other constraint measures must not be used with a view to procure evidence.

11. In case of serious offences, does your legal system allow for limiting- the right to habeas data (data protection, private life) or the right to habeas corpus (arrest, detention, deportation, extraordinary rendition, etc.)?

Judicial authorities may intervene in a person's private life by constraining his right as to the inviolability of the domicile, by intercepting and recording conversations, phone conversation including, with the help of communication electronic means, and also by intercepting and retaining correspondence.

As we have already noticed, these constrains may be applied especially in the case of grievous offences (e.g. offences against national security as they are stipulated in the Criminal Code and special laws, drugs and guns trafficking offences, the traffic of persons, terrorism acts, money laundry, money forgery or the forgery of valuable objects, corruption acts).

As far as domicile search is concerned, there are no relative criteria as to the seriousness of the offence. However, in contrast with the other instances of aggrieving somebody's right to private life, which can occur even before the criminal trial starts, in the

stage preliminary to the criminal trial, the violation of the domicile by search can be performed only after the criminal investigation is enforced.

Preventive detention may be ordered in the criminal trial in Romania only if the sanction provided by law for the committed offence is life imprisonment or imprisonment for a period longer than 4 years. In other words, the processual regime for adopting such preventive measures does not take into consideration the distinction between summary and indictable offences.

Individual freedom may also be constrained by means of an intermediary European arrest warrant, a judicial decision issued by a competent judicial authority of a EU member state, with a view to arrest a wanted person and send him/her to another member state for him/her to be criminally investigated or in order to apply a penalty or to deprive somebody of liberty (article 77. 1 of the Law no. 302/2004 on the international judicial cooperation in criminal matters^{cvi}). Basically, the execution of such a warrant is subsequent to the accusation of having committed a grievous offence.

SECTION IV

Dispositions applicable before the judgement of the criminal causes

12. Has the national judicial system developed the investigation prerogatives and the coercitive prerogatives of the authorities, as well as the processual obligations to cooperate with the judicial authorities on the part of the investigated person?

Basically, the investigation attributes and the coercitive prerogatives of the criminal judicial authorities have developed lately, and this is proved by the fact that the criminal policy of limiting the socially highly dangerous infractional phenomena has been implemented in our country. Under these circumstances, however, we have noticed that in certain areas the need for defending certain fundamental rights and liberties prevailed, as an imperative for doing justice.

Thus, as to the procedure applied in domicile search, and as a consequence of the modifications brought by Law no.281/2003 and Law no. 356/2006, one can remark the following aspects:

- domicile search can be ordered only by a judge, in comparison with the previous period when the violation of the domicile could be ordered only by a prosecutor^{cix};
- domicile search can no longer be applied outside the processual framework, and the existence of a disposition for initiating criminal investigation is a necessity; previously domicile search could also be made in the preliminary stage of the criminal case;
- a search warrant can be used only once and it specifies the period for which it was issued.

In the same way, one can remark the legislative change made during the year 2003 according to which the measures adopted for insuring the defendant's goods or the civilly responsible person during the criminal investigation can no longer be ordered by judicial police bodies, since it is exclusively an attribute of the prosecutor.

As to the interception and recording of conversations or other communications, one can remark an increase of the judicial bodies' prerogatives, to the detriment of the rights to defence (the modification of the legal framework was made in 2006). In this respect, we underline the modification of the dispositions according to which interceptions and recordings may be provisorily disposed by the prosecutor, too. Thus, in the previous regulation, the duration of these provisory recordings was mentioned, and the prosecutor was obliged to immediately (anyway, no later than 24 hours from the beginning of the interception or recording) announce the instance about the probatory acts that were enforced. According to the present regulation, provisory interception and recording can be disposed for a term no

longer than 48 hours. At the same time, another difference from the previous regulations consists of the fact that instance will be informed by the prosecutor within 48 hours from the expiration of the duration when these may be made without the judge's authorization. It results that, according to the previous norms, the judge was informed about the interceptions and recordings, without his authorization, in an interval no longer than 24 hours since the ordinance was issued, while, *de lege lata*, the prosecutor will inform the judge about this fact in an interval no longer than 96 hours.

Another modification of the legislation on interceptions and the recording of conversations or any other communications exists as to the conversations or communications between the lawyer and the party to whom he offers juridical assistance. Thus, before 2006, according to article 91³.(7) from the Code of Criminal Procedure, the recording of the conversations between the lawyer and the offender may not be used as a piece of evidence in the criminal trial. *De lege lata*, in conformity with article 91¹.(6) from the Code of Criminal Procedure, the recording of the conversations between a lawyer and the party he represents or assists in court may be used as evidence in the trial if this conversation contains concluding and useful data or information about the lawyer's intention to commit or the lawyer's committal of a serious offence, such as the ones provided by article 91¹ (1) and (2) from the Code of Criminal Procedure.

We also mention the possibility of using undercover investigators in the criminal trial, starting with 2000, especially in investigating organized crime offences and corruption acts.

In our judicial system, there are no processual obligations according to which those accused of having committed offences should be bound to cooperate with the judicial authorities. The defendant does not have to prove his/her innocence, the judicial bodies are obliged to administrate the evidence in the criminal trial (*ejus incubit probatio qui dicit, non qui negat*). Yet, in practice constraints are laid on the statements made by the persons suspected of having committed offences by regulating impunity situations or by reducing the punishment if the suspect cooperates (article 16 of the Law no. 143/2000, in the drug dealing matters, article 20 of the Law no. 678/2001 as to the traffic with persons, article 23 of the Law no. 656/2002 as to money laundry or article 9 of the Law no. 39/2003 as to organized crime). The suspects are informed of these legal provisions before they are subject to interrogation recorded in the form of minutes.

13. Did a shift of powers occur in your country?

Important judicial attributes have been transferred from the competence of the criminal investigation bodies to the judges' competence, in the stage of criminal prosecution. We mention several of the most important changes made especially during 2003:

- the defendant's preventive detention is exclusively disposed by the judge; previously, the prosecutor could dispose the preventive detention for no longer than 30 days or provisory arrest for 3 days;
- provisional release may be disposed for the arrested persons only by the judge;
- hospitalization or compulsory medical treatment of the defendant may be disposed only by the judge;
- interception and recording of conversations or other communications is authorized by the judge; only in exceptional cases, the prosecutor may authorize this probatory method;
- retention and correspondence delivery is disposed by the judge; only in exceptional cases, the prosecutor may authorize this probatory procedure;
- domicile search is disposed only by the judge;
- the judge has the possibility to deny the prosecutor's dispositions for not prosecuting a person and, in certain circumstances, he may return the cause to the prosecutor with the decision to enforce a criminal prosecution.

As to the shift of powers from the judicial police bodies to the Public Ministry, one can notice an increase in the number of offences for which criminal prosecution may be exclusively enforced by prosecutors and, consequently, a decrease in the number of offences for which the criminal prosecution is enforced by judicial police bodies. At the same time, according to the same logic, the functional subordination of judicial police to the Public Ministry has been accentuated, and there are legal dispositions according to which judicial police employees may not receive from their superior bodies any other task apart from exceptional situations and events or for accomplishing preparatory tasks and professional training^{cx}.

14. Did a specialization and/or centralization of the judicial investigative authorities take place in your country?

As to the organization of the criminal investigation bodies, one can speak about a specialization and centralization thereof. In this respect, we mention the organization within the Public Prosecutor's Office attached to the High Court of Cassation and Justice, of NAD^{cx} and DIOCTO^{cxii}.

Thus, the National Anticorruption Directorate (N.A.D.) exercises its powers by its prosecutors specialized in fighting against corruption, and it is subordinated to the General Public Prosecutor of the Public Prosecutor's Office attached to the High Court of Cassation and Justice. NAD is headed by a Chief Prosecutor who is assisted by two Deputy Chief Prosecutors. The organizational structure comprises sections that are subordinated to prosecutor's chiefs of sections, helped by their deputies. At the same time, territorial sections, services, offices and other activity compartments may be set up, at the Chief Prosecutor's order. Within the National Anticorruption Directorate there are prosecutors, officers and judicial police agents, specialists in economics, the banking, financial, customs and IT fields as well as in other fields, auxiliary specialized staff, as well as economists and administrative staff.

The Directorate for Investigating Organized Crime Offences and Terrorism Acts (D.I.O.C.T.O.) is a structure within the Public Prosecutor's Office attached to the High Court of Cassation and Justice specialized in fighting against organized crime offences and acts of terrorism. The Directorate is headed by a Chief Prosecutor, helped by a Deputy Chief Prosecutor, being coordinated by the General Prosecutor of the Public Prosecutor's Office attached to the High Court of Cassation and Justice.

The Directorate for Investigating Organized Crime Offences and Terrorism Acts consists of the following services (within which offices can be set up), subordinated to chief prosecutors: a) the service for fighting against organized crime; b) the service for fighting against drug dealing; c) the service for fighting against economic and financial macro criminality; d) the service for fighting against computer criminality; e) the service for fighting against acts of terrorism.

Thus, grievous forms of criminality created particular competences. The regulator took as a starting point the premise according to which special techniques for investigating the evidence are necessary for this directorate to adopt in order to be efficient since this directorate has to fight against well organized networks. In consequence, specialized structures are necessary both within national police and within the Public Ministry. In practice, however, although both laws of organization and functioning impose the necessity of having specialized personnel, for the public prosecutor's offices to be prepared to fight against serious offences, one can notice that magistrates do not always have the proper training, and thus their specialization is not applied in a concrete manner. However, not the same thing can be said about judicial police employees, who work in these specialized offices and who have a real specialization, being organized and equipped properly.

These specialized public prosecutor's offices have an exclusively material competence, of initiating their own criminal prosecution for serious offences: corruption acts, organized crime and acts of terrorism, and also a territorial competence, which goes beyond the ordinary competence of the public prosecutor's offices attached to the court of justice. Article 13 of the Government Emergency Ordinance no. 43/2002 stipulates the special competence of NAD and it sets forth that "specialized NAD prosecutors are bound to enforce the criminal prosecution for the offences provided in section 1, 1¹ and 1²". Criminal prosecution for the causes provided for the offences mentioned in section 1, 1¹ and 1², committed by active military staff, "shall be enforced by the NAD military prosecutors, no matter the military rank which the investigated persons may have". Article 13 of the Government Emergency Ordinance no. 43/2002 regulates a material competence of the anticorruption prosecutors, without making a distinction, in this respect, between the central and territorial structure of NAD. A similar regulation is also stipulated by Law no. 508/2004 (article 12), which, after enumerating the serious offences that come in the DIOCTO competence, section 2, sets forth that "specialized prosecutors from DIOCTO are bound to enforce the criminal prosecution for the offences provided in section 1", while for the offences provided in section 1 and committed by juveniles or against juveniles, "criminal prosecution shall be enforced by DIOCTO prosecutors, especially appointed by the General Public Prosecutor from the Public Prosecutor's Office attached to the High Court of Cassation and Justice", without making a distinction between the competence of the central structure and the territorial structure (services and offices), which is similar with a competence parity at a national level.

15. Were the rules in your legal system changed on the conditions to approve coercive measures, the disclosure of evidence, or the conditions for arrest and detention?

As to the adoption of coercive processual measures, the most important change is the transfer of competences from the criminal investigation bodies to the judge.

As a general feature, these coercive measures might come in contradiction with the acts which define them as being against the legal provisions in force or by which the right to a fair trial is aggrieved. For all instances, a general condition is required to justify the measures taken: the proofs beyond reasonable doubt. Thus, police actions are conditioned, in all circumstances, by the existence of proofs beyond reasonable doubt as to the committal of an offence. The definition of the beyond reasonable doubt proofs is to be found in article 68 from the Code of Criminal Procedure, introduced by Law no. 356/2006. According to this article, "we can speak about proof that is beyond any reasonable doubt when the existing data indicate as reasonable the supposition that the person - for whom preliminary acts and criminal investigation acts are enforced - committed the deed". For acts of terrorism provided by Law no. 535/2004 and for offences that threaten national security, the regulator has lowered the standard of the probability from the terms "beyond reasonable doubt evidence" to the simple terms "data" or "clues". The law does not contain a definition thereof, but, if we relate them to the words "beyond reasonable doubt evidence" it is obvious that there is a less exigent condition than in the case of the other offences.

The file does not contain probatory means that are not accesible to the defence, but, there are instances when information is accessible only to the criminal judicial bodies. Thus, for the witnesses used in the national program for the protection of witnesses, their identity data are not accessible to the parties in the trial. The application of this probatory method means accomplishing a condition which would ensure the protection of the witness's identity. In other words, the witness's identity is secret to the parties involved in the criminal trial, if there is evidence or if there are proofs or if there is solid evidence that by declaring the real identity or the domicile or the residence, the witness's or another person's life, body integrity

of freedom would be in danger. At the same time, the information about the real identity of the undercover investigators may not be known by the parties in the trial. These data are protected by the professional secret.

In the criminal processual system from Romania, there is no possibility to retain or preventively and secretly arrest, or deport or extradite somebody, thus infringing habeas corpus.

16. Is pre-trial evidence, gathered by police and judicial authorities, subject to judicial control (admissibility of pre-trial evidence) in your country? Are there special measures in the field of serious offences?

According to article 275 from the Code of Criminal Procedure, any person can file a complaint against the measures and the criminal prosecution acts, if that person considers that these measures and acts harmed his/her legitimate interests. The complaint is addressed to the prosecutor who supervises the activity of the criminal investigation body and is submitted either directly to him or to the criminal investigation. The prosecutor must settle the complaint within maximum 20 days from receiving it and communicate immediately to the person who filed it the way in which it was settled.

At the same time, according to article 278¹ from the Code of Criminal Procedure, the person harmed (as well as any other persons whose legitimate interests were harmed) may file a complaint to the court of justice against the prosecutor's acts for the latter not to reinforce the criminal prosecution or to take legal actions.

Last but not least, according to article 332 from the Code of Criminal Procedure, during the trial, one may bring into discussion the admissibility of the evidence administrated during the criminal prosecution by infringing the norms relative to material competence (*rationae materiae*), personal competence (*personae materiae*), the notification of the court of justice, the presence of the defendant and his assistance by the lawyer. In this situation, the instance may dispose the return of the file *ex officio* or at the interested party's request, with a view to reconceive the file.

As to the serious offences, there are no norms derogatory from these provisions.

17. Does your country allow for the use of evidence obtained abroad (extraterritorial use of evidence)?

According to Law no. 302/2004 on international judicial cooperation for criminal matters, the evidence obtained abroad may be sent in the criminal trial in Romania. We refer to the procedure of the international rogatory commission, surveilled delivery, undercover investigations.

Thus, according to article 161. (1) of the Law no. 302/2004 on international judicial cooperation on criminal matters, the object of the rogatory commission request is mainly represented by: a) the localization and identification of the persons and objects; the defendant's hearing, the harmed party's hearing, the other parties' hearing, the witnesses' and experts' hearing, as well as confrontation; search, confiscation by force of objects and writings, seizure of objects and special confiscation; field investigation; expertises, technical-scientific and legal-medical acknowledgments; sending information necessary in a certain trial, interceptions and audio and video recording, analysing the documents in the archive and the specialized files as well as other procedural acts; b) transmitting material evidence; c) delivering documents or files.

The aim of rogatory commissions is to make searches, to confiscate goods and writings and to seize goods. These commissions are subject to the following conditions: a) the offence which motivates the rogatory commission must be susceptible to provide extradition

in Romania, as a solicited state; b) the activity of the rogatory commission is to be compatible with the law of the Romanian State^{cxiii}.

At the same time, at the request of the Romanian judiciary bodies, the foreign judiciary bodies may authorize surveilled delivery for a criminal procedure on offences that can imply extradition^{cxiv} (article 167 of the Law no. 302/2004). The Romanian and foreign judiciary bodies may agree to mutually assist themselves with a view to plan investigations with undercover agents (article 168 of the Law no. 302/2004).

18. Have coercive measures been introduced in such a way that they could definitely preclude fair trial norms?

According to article 136. (1) and (2), the Code of Criminal Procedure, in those causes involving offences punished with life imprisonment or imprisonment, with a view to ensure the good development of the criminal trial or with a view to block the escaping from investigation/trial/ punishment of the guilty person, one of the following measures may be adopted: a) the hold measure; b) the obligation not to leave the locality; c) the obligation not to leave the country; d) preventive arrest. Preventing measures may also be adopted by provisional release under judicial control or on bail.

In the same way, the obligation to take medical treatment is a consequence of the fact that the defendant committed an offence because he is ill, drunk, intoxicated with drugs or other substances that are dangerous for society (article 113, The Criminal Code). The security measure of hospitalizing that person implies the fact that the accused person is mentally ill or is a toxicoman and finds him/her in a condition that is dangerous for society (article 114, the Criminal Code).

As to the assurances measures, they are adopted during the criminal trial, by seizing the mobile and imobile goods, in order to execute a special confiscation, with a view to repair the damage caused by the committed offence, as well as by guaranteeing the payment of the fine (article 163. (1), the Code of Criminal Procedure).

As to the coercive measures that may be adopted by the criminal judicial bodies during the whole criminal trial, we also make reference to the interceptions and recordings of conversations or other communications, the interception of correspondence, domicile search, the use of undercover investigators. All these aspects referring to probatory acts in the criminal trial - if they do not infringe the legal frame of the Code of Criminal Procedure and of the special laws - can not lead to the remark that criminal trial was not a fair one. Such a conclusion may be drawn only if – by the coercitive processual measures adopted or the probatory methods enumerated above – criminal processual norms are infringed.

19. Were special measures introduced in your country for the protection of the secrecy of witnesses, victims, judges, etc.?

The new forms of criminality - such as terrorism acts, organized crime, drug dealing or gun traffic, or traffic in human beings, etc. – have substantially modified the ordinary provisions for hearing witnesses. Consequently the Code of Criminal Procedure has adopted several special measures for protecting the witnesses from potential threats, so that criminal justice would not fail to convict the guilty ones. The protection of witnesses may be accomplished in different ways, starting with an extraprocedural protection, stipulated in Romania by Law no. 682/2002 on the protection of witnesses^{cxv} according to which a program for the protection of witnesses is set up. The notion of protected witness has an autonomous meaning and it comprises, in conformity with the European requests on the matter, both the witness, and the members of his/her family (husband or wife, parents and children), and also close friends. The regulation stipulated in article 86¹-86⁶ from the Code of Criminal Procedure, introduced by Law no. 281/2003, provides specific ways for protecting

the witness during the enforcement of the judicial proceedings. In general, this protection means not revealing the identity of the respective person. Taking into consideration the fact that such measures may affect the exercise of the right to defence, special protection measures are accompanied by processual elements for balancing the processual position of the parties, in conformity with the provisions of article 24 and article 53 from the Constitution, as well as the dispositions provided in article 6 of the European Convention and the CEDO case law in this respect^{cxvi}.

The conditions concerning the ensurance of the anonimate, as well as the conditions under which a person may be heard without being physically present are strict, and they are provided in article 86¹ and 86², the Code of Criminal Procedure. These conditions refer to the protection of the data by which the witness could be identified and to the special measures adopted for hearing him/her. Thus, the protection of the witness is admissible only if there is evidence or there are solid grounds to prove that the revealing of the witness's identity or of some information concerning his domicile or residence, could endanger his life, corporal integrity, his freedom or the freedom of another person whom the witness loves. The change of identity during the judicial procedures may be disposed by the prosecutor for the criminal prosecution stage, by an ordinance. If the case is tried in court, then the change of identity may be ordered by the judicial body, after it has found out the real identity of the witness and after it has analysed the aspects concerning the existing pressure, the measure to be adopted and the credibility of that witness.

Law no. 356/2006 introduce in article 77¹ of the Code of Criminal Procedure, similar provisions according to which the harmed person and the civil party (the victim of the offence) may be heard, by using special methods if their life, body integrity of freedom or their relatives' freedom would be in danger. Special protection measures are introduced in the Code of Criminal Procedure for hearing the anonymous witnesses. In this way, the provisions on the hearing of the victim provided by the Code of Criminal Procedure were brought into line with several special laws, such as Law no. 678/2001 on preventing and fighting against traffic in human beings, as well as with the new concept of "witnesses" which is stipulated by Law no. 682/2002 on the protection of witnesses.

As to the protection of magistrates, respectively the judges and prosecutors who are employed or retired, there is a special regulation in Law no. 303/2004 republished^{cxvii}, in article 77. (1) which provides that prosecutors have the right to enjoy special protection measures against threats, violence or any other deed that might endanger themselves, their families or goods. The second section of article 77 from the same law also provides that special protection measures and the conditions for their accomplishment are established by Government decision, at the proposal of the Ministry of Justice and the Ministry of Internal Affairs.

The implementation of regulations ensures only the protection of anonymous witnesses, of the persons who were victims or of the magistrates, as the case may be, but they do not have a coercive effect on the offenders. They have a double connotation: first, they attempt to find out the truth in complex criminal matters, and secondly they attempt to protect these categories of people of the potential threats that might come from the part of the offenders or the offenders' close friends.

SECTION V

Trial setting (criminal proceedings, special proceedings)

20. When dealing with serious offences, does your legal system foresee special rules concerning jurisdiction, the organization of the trial, the protection of the secrecy of witnesses, victims, judges evidence and proof at trial?

Derogatory norms as to trying serious offences are not provided. Basically, these offences come in the jurisdiction of the court of justice (money laundry, drug dealing and consumption, corruption acts, traffic in human beings or anything which has to do with human beings, offence to initiate or create an infranational group, etc.).

Other serious offences are tried in the court of appeal. These are: offences that threaten national security of Romania, offences against peace and mankind, terrorism acts.

In Romania there are specialized courts of justice, in accordance with the provisions of article 126. (5) from the Constitution, according to which by organic law specialized courts can be set up, in which persons who are not magistrates can work. Thus, in Constanța and Galați, for criminal matters, there are specialized sections for trying offences committed at sea. In Brașov a specialized court for juveniles and family matters has been set up. Here are tried the offences committed by juveniles against juveniles. According to these provisions, one can notice that the Romanian judicial system lacks specialized courts for offences which represent a very serious social threat.

The disposition not to take into consideration a certain piece of evidence for solving a criminal cause - evidence that is included in the file (and about which the magistrate appreciated that it is pertaining, concluding and useful for revealing the truth) – may be grounded on the fact that that very piece of evidence does not corroborate with the other pieces of evidence existing in that criminal cause. Under these conditions, no distinctions are made between the evidence used for defence or prosecution.

21. When dealing with serious offences, does your legal system fully provide for the right of the suspect/accused/detained person to an independent and impartial tribunal?

The suspect's or defendant's right to an independent and impartial trial, the presumption of innocence, the right to be judged without undue delay, the right to invoke the lawfulness of preventive arrest, the right to invoke the adagium in dubio pro reo – all are regulated in the Romanian Code of Criminal Procedure. Besides, the regulator does not make any difference between summary offences and indictable offences.

The public character of the trial is a basic principle for the trying of the causes, and there are norms in the Romanian Constitution, the Code of Criminal Procedure and in the Law no. 304/2004 on the judicial organization that regulate this principle. As to serious offences there are no further norms concerning the public character of the trial.

In the same way, we can notice that applicable procedure is not derogatory, according to the distinction between indictable/summary offences. Consequently, there are no specific regulations for serious offences as to the right to assist to one's own trial, the right of the defender to have access to all constitutive elements of the file, the right to be informed without delay about the offence one is accused of, the right to know the evolution of the criminal proceedings and the right to benefit of an adequate period of time for preparing the defence strategy, the right to make public the elements of the case (between the involved parties) and to make public the proceedings, the right to examine the declarations of the aggrieved person and to obtain the presence and hearing of the defence witnesses in the same conditions like the prosecution witnesses, special measures for anonymous witnesses or for those that are part of a protection program (undercover agents, intelligence agents), the right to benefit for free of an interpreter's services, the right not to make a deposition against one's own, the right to have a defender (elected or appointed ex officio), the right to remain silent. All these processual rights are provided by criminal processual legislation for the trial setting stage. Further provisions for grievous offences do not exist.

However, there are limitations imposed on the exercise of these processual rights for the offenders accused of having committed indictable offences. These limitations are

determined either by the nature of the offence, or by the probatory object. Thus, as to the offences that threat national security, the public character of the trial may be derogated, if it is supposed that the public character of the trial might cause harm to the interests of the state. At the same time, defence does not have access to the elements of real identity or to other information that might endanger the life, corporal integrity of the witness or any other persons in criminal cases in which declarations of witnesses included in the national protection program are used or in criminal cases in which probatory elements obtained by undercover investigators are used.

SECTION VI

Post-trial setting (criminal, special proceedings)

22. When dealing with terrorism and serious offences, did your legal system modify the right of a higher court to review the sentence (appeal, cassation, constitutional review), the prohibition of double jeopardy, following either an acquittal or finding of guilt and punishment?

Judicial decisions can be criticized by attacking the court rulings. The principle of attacking the court rulings is stipulated in article 129, according to which the interested parties and the Public Ministry can establish their ways of attacking the court ruling in conformity with the provisions of law.

In the criminal trial in Romania, ordinary ways of attacking the court ruling (the appeal and the recourse) and the extraordinary ways of attacking the court ruling (appeal for annulment and review) are regulated by law. There are no derogatory norms as to the use of these ways of attack in the cases in which grievous offences are tried.

At the same time, after a final decision is passed - by which the guilt of innocence of the defendant is proved - it is impossible to enforce a new criminal investigation for the same deed and the same person, no matter what the nature of the offence is. In this respect, article 10 let. (j) from the Code of Criminal Procedure includes an impediment to the initiation of the criminal prosecution, and that is double jeopardy (authority of tried matter). Thus, the seriousness of the offence is no longer important when applying this concept in court.

SECTION VII

Conclusions

Taking as a premise the Code of Criminal Procedure provisions, and taking into consideration the numerous laws adopted for altering and adnotating this Code – which outlines, with a few exceptions, the ordinary criminal procedure – we can notice that the legislative in our country has passed many special laws which have substantially regulated the criminal procedural measures imposed as a necessity by the specific and complex categories of indictable offences (the ones referring to corruption, grievous criminality and terrorism). These measures, as we have seen above, gradually transform traditional criminal procedure into a new one, which appears as an alternative to the former one. The new criminal procedure is organized in conformity with the types of offences ennumerated above, and it is justified by the present need to prevent them and fight against them. Although exceptional procedures are being adopted and they are applicable only to certain categories of offences, the principles that guarantee the protection of individual liberties still subsist, but they are completed by a larger and larger number of exceptions, justified both by the present very grievous infractional phenomena and by the limited character of the aggravance caused to individual liberties. Basically, the monitoring of these specific offences justifies the adoption of exceptional investigation means. The notion of organized crime is at the core of these

exceptional regimes, since the international character of these criminal phenomena, its structured organization and the seriousness of the offences that generate them impose the adoption of new investigation means as a necessity.

These techniques allow judicial police and its prosecutors to intervene in criminal cases in a more precocious manner, and they have effect on a criminogenous environment even before the offence is committed^{cxviii}. These techniques put to good use the informers and justice collaborators, wire tapping and conversation or communication recording, anonymous witnesses, the infiltration of provoking agents into criminal networks, as well as by means of other techniques which facilitate the previous knowledge of the offenders' intentions, even by taking part in the activities the former perform. Without discussing about the actual effectiveness of these techniques, which is to be demonstrated from case to case, criminal phenomena are certain to seriously aggrieve individual freedoms and fundamental rights. The principle of contradictness, the principle of loyalty in reinterpreting evidence, the principle of respecting private life, as well as the one of safeguarding individual freedom (the freedom to go and to come) are regarded as being of secondary importance in order to facilitate police and prosecutors' intervenience in criminal acts presented as particularly dangerous.

ⁱ „Nicolae Titulescu” University of Bucharest, Faculty of Law.

ⁱⁱ „Babeş Bolyai” University of Cluj Napoca, Faculty of Law.

ⁱⁱⁱ „Nicolae Titulescu” University of Bucharest, Faculty of Law.

^{iv} The Romanian criminal procedure is codified, i.e. all the judicial norms it comprises are systematized in a single law: The Code of Criminal Procedure. The Romanian Code of Criminal Procedure, which represents the main common source of criminal procedure, came into force on 1st January 1969 (initially published in the Official Bulletin of Romania no. 145 – 146 on 12th November 1968, and then republished in the Official Bulletin of Romania no. 58 – 59, on 26th April 1973, respectively in the Official Gazette of Romania no. 78, on 30th April 1997). At the same time, the Romanian Code of Criminal Procedure has been modified and adnotated for many times so far with a view to bring into line its existing dispositions with the European requirements and the ones provided by the Constitution, to point out competences and adopt new regulations, especially with reference to the deterrence measurements, evidence and ways to fight against criminality. In this respect, one can notice that there are new formal sources for criminal procedure: international and constitutional sources. At the same time, one can notice that there is an inclination towards the fundamental rights, which is one of the great metamorphoses of any law system at the end of this century, as well as the tendency towards globalization of criminal procedure and the appearance of new directing principles.

^v The Official Gazette of Romania no. 229, 14th November 1996.

^{vi} The Official Gazette of Romania no. 594, 22nd November 2000.

^{vii} The Official Gazette of Romania no. 707, 30th December 2000.

^{viii} The Official Gazette of Romania no. 410, 25th July 2001.

^{ix} The Official Gazette of Romania no. 326, 18th June 2001.

^x The Official Gazette of Romania no. 594, 1st July 2004.

^{xi} The Official Gazette of Romania no. 807, 17th December 2001.

^{xii} The Official Gazette of Romania no. no. 2, 4th January 2002.

^{xiii} The Official Gazette of Romania no. 261, 18th April 2002.

^{xiv} The Official Gazette of Romania no. 351, 27th May 2002.

^{xv} The Official Gazette of Romania no. 470, 2nd June 2005.

^{xvi} The Official Gazette of Romania no. 453, 27th June 2002.

^{xvii} The Official Gazette of Romania no. 783, 30th October 2002.

^{xviii} The Official Gazette of Romania no. 468, 1st July 2003.

^{xix} The Official Gazette of Romania no. 502, 11th July 2002.

^{xx} The Official Gazette of Romania no. 635, 5th September 2003.

^{xxi} The Official Gazette of Romania no. 748, 26th October 2003.

^{xxii} The Official Gazette of Romania no. 451, 20th May 2004.

^{xxiii} The Official Gazette of Romania no. 592, 1st July 2004.

^{xxiv} The Official Gazette of Romania no. 1164, 8th December 2004.

^{xxv} The Official Gazette of Romania. no. 594, 1st July 2004.

^{xxvi} The Official Gazette of Romania no. 909, 6th October 2004.

^{xxvii} The Official Gazette of Romania no. 1210, 16th December 2004.

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- xxviii The Official Gazette of Romania no. 1088, 23rd November 2004.
- xxix The Official Gazette of Romania. no. 1223, 20th December 2004.
- xxx The Official Gazette of Romania no. 1179, 28th December 2005.
- xxxi The Official Gazette of Romania. no. 629, 20th July 2006.
- xxxii The Official Gazette of Romania no. 677, 7th August 2006.
- xxxiii The Official Gazette of Romania no. 764, 7th September 2006.
- xxxiv The Official Gazette of Romania no. 225, 2nd April 2007.
- xxxv The Official Gazette of Romania no. 224, 24th March 2008.
- xxxvi The Official Gazette of Romania no. 228, 25th March 2008.
- xxxvii According to article 229 the Code of Criminal Procedure, “The person criminally investigated is called defendant as long as criminal action has not been initiated against him”.
- xxxviii According to article 23 the Code of Criminal Procedure, “The person against whom criminal action has been initiated is part of the criminal trial and is called defendant”.
- xxxix See Decree no. 224/11.05.1990 which ratifies the additional protocols I and II to the Geneva Conventions (The Official Gazette of Romania, Part I, no. 68-69/14.05.1990); Law no. 32/26.04.1995 regarding the acceptance by Romania of the amendments to annex no. I of the additional Protocol no. I to the Geneva Conventions in 1949 (The Official Gazette of Romania, Part I, no. 82/4.05.1995); Law no. 277/15.05.2002 on retracting the reserves expressed by Romania to the four Geneva Conventions for protecting the war victims (The Official Gazette of Romania, Part I, no. 368/31.05.2002).
- xl The international agreement relative to the economic, social and cultural rights and the international Agreement relative to the civil and political rights were ratified by the State Council Decree no. 212/31.10.1974, published in the Official Gazette of Romania no. 146/20.11.1974.
- xli See Law no. 19/10.10.1990 published in the Official Gazette of Romania, Part I, no. 112/10.10.1990.
- xlii See Law no. 80/30.09.1994 published in the Official Gazette of Romania, Part I, no. 285/7.10.1994.
- xliii See Government Emergency Ordinance no. 91/30.08.1999 published in the Official Gazette of Romania, Part I, no. 425/31.08.1999.
- xliv See Law no. 30/18.05.1994 on the ratification of the Convention for safeguarding human rights and fundamental freedoms as well as the protocols added to this convention (the Official Gazette of Romania, Part I, no. 135/31.05.1994); Law no. 79/6.07.1995 on the ratification of Protocol no. 11 to the Convention for safeguarding human rights and fundamental freedoms, on restructuring the control mechanism established by convention, concluded at Strasbourg on 11th May 1994; Law no. 7/9.01.2003 on ratifying Protocol no. 13 to the Convention for safeguarding human rights and fundamental freedoms concerning death penalty abolishment, concluded at Vilnius 3rd May 2002 (the Official Gazette of Romania, Part I, no. 27/20.01.2003); Law no. 345/12.07.2004 on approving the retraction of the reserve expressed by Romania as to article 5 in the Convention for safeguarding human rights and fundamental freedoms, adopted in Rome on 4th December 1950 (The Official Gazette of Romania, Part I, no. 668/26.07.2004); Law no. 39/17.03.2005 on the ratification of the Protocol no. 14 to the Convention for safeguarding the human rights and fundamental freedoms, adopted in Rome on 4th November 1950, as to the modification of the control system of the Convention, adopted in Strasbourg on 13th of May 2004 (The Official Gazette of Romania, Part I, no. 238/22.03.2005); Law no. 103/25.04.2006 on ratifying the Protocol no. 12 to the Convention for safeguarding the human rights and fundamental freedoms, adopted in Rome on 4th November 2000 (The Official Gazette of Romania, Part I, no. 375/02.05.2006).
- xlv The criterion referring to the necessity of limitation – which is of significant importance in a democratic society – constitutes a reference element in particularly analysing every situation, both for the regulator, when he adopts such measurements, and for the constitutional judge, when he/she is asked to adjudicate on the constitutionality of such a measure. (See **M. Constantinescu, A. Iorgovan, I. Muraru, E.S. Tănăsescu, Constituția României revizuită**, comentarii și explicații, Editura All Beck, București 2004, p. 109)
- xlvi The Constitutional Court Decision no. 809 passed on the 9th November 2006 on the objection of unconstitutionality concerning adopted dispositions, article 19 in Law no. 682/2002 on the protection of witnesses (The Official Gazette of Romania, no. 29, 17th January 2007). The Court has decided that the principle of equality of rights does not imply uniform juridical approach for all offences, and that the regulation of a sanctioning regime in concordance with the conduct of the persons who are under criminal investigation is the natural implementation of the constitutional principle mentioned above, and according to this principle the same regime should be applied to each juridical situation, and as for different juridical situations they should also be differently approached from a juridical point of view. This is a criminal policy measure adopted to deter grievous antisocial phenomena, such as organized crime, terrorism, drug dealing and traffic in human beings, and to implement a system of measures with a view to protect witnesses, while not affecting the principle of equality of rights. Basically, the Constitutional Court has agreed on the regulator’s providing special criminal procedure rules in conformity with the facts, situations and the persons to which they are addressed and on condition that

these rules should not allow unjustified discrimination to be made and equal guarantees to be offered to the regulators

^{xlvii} **L. Mihai, R. P. Vonica, I. Muraru, N. Popa**, *Opinie separată* as to the Constitutional Court Decision no. 124, 26th April 2001, The Official Gazette of Romania no. 466, 15th August 2001

^{xlviii} ECHR, 1st July 1969, Lawless c. Ireland series A, no. 3; ECHR 6th December 1978, Klass ş. a. c. Germany, series A, no. 28. (48).

^{xlix} ECHR, 18th January 1978, Ireland c. U.K., series A, no. 25. (47).

ⁱ ECHR, 6th December 1988, Barbera, Messegue and Jobardo c. Spain, series A, no. 146. (78) (it has been established that the evidence should be exposed to adversarial debate); ECHR, 26th March 1996, Doorson c. the Netherlands, Recueil II, 1996, no. 6, p. 446 (it has been accepted that a conviction cannot be exclusively or decisively grounded on anonymous statements).

ⁱⁱ Judicial guarantee is provided in article 23. (4) and article 27. (3) of the Constitution relative to the exclusive competence of the judge in ordering preventive custody and authorising domicile search, as well as in article 21 of the Constitution relative to free access to justice.

^{lii} The Official Gazette of Romania no. 219, 18th May 2000.

^{liii} The Official Gazette of Romania no. 279, 21st April 2003.

^{liv} The Official Gazette of Romania no. 244, 11th April 2002.

^{lv} The Official Gazette of Romania no. 50, 29th January 2003.

^{lvi} The Official Gazette of Romania no. 904, 12th December 2002.

^{lvii} The Official Gazette of Romania no. 1961, 8th December 2004.

^{lviii} The Official Gazette of Romania no. 1155, 7th December 2004.

^{lix} The Official Gazette of Romania no. 783, 11th December 2001.

^{lx} The Official Gazette of Romania no. 1089, 23rd November 2004.

^{lxi} The Official Gazette of Romania no. 1155, 7th December 2004.

^{lxii} The Official Gazette of Romania no. 1039, 28th December 2006.

^{lxiii} As to **human trafficking**, Romania has ratified the United Nations Convention against transnational organized crime, the Protocol on preventing, repressing and sanctioning the traffic of human beings, especially of women and children, additional to the United Nations Convention against transnational organized crime, as well as the Protocol against the illegal traffic of human beings on land, via air and at sea, additional to the United Nations Convention against transnational organized crime, adopted in New York, 15th November 2000. (Law no. 565/16.10.2002, published in the the Official Gazette of Romania, Partea I, no. 813/9.11.2002).

^{lxiv} The Official Gazette of Romania no. 18, 21st January 1999.

^{lxv} The Official Gazette of Romania no. 333, 30th April 2008.

^{lxvi} The Official Gazette of Romania, no. 279, 21st April 2003.

^{lxvii} As to the fight against **terrorism**, relevant international acts have been ratified, of which we mention: the International Convention on Repressing the Financing of Terrorism, adopted in New York on 9th December 1999^{lxvii}, the European Convention for Repressing Terrorism^{lxvii}, the International Convention against Nuclear Terrorism Acts, signed at New York on 14th September 2005^{lxvii}, the European Council Convention on preventing terrorism, adopted at Varşovia on 16th May 2005^{lxvii}, the European Council Convention on money laundry, identifying, seizing and confiscating the products that made the object of the offence as well as identifying the sources for financing terrorism, adopted at Varşovia on 16th May 2005^{lxvii} (Law no. 623/19.11.2002, published in the The Official Gazette of Romania, Part I, no. 852/26.11.2002. Law no. 19/28.02.1997, published in the Official Gazette of Romania, Part I, no. 34/4.03.1997. At the same time, the Protocol for amending the European Convention for repressing terrorism acts was ratified and adopted at Strasbourg on 15th May 2003 (Law no. 366/15.09.2004, published in the Official Gazette of Romania, Part I, no. 913/7.10.2004). Law no. 369/2.10.2006, published in the Official Gazette of Romania, Part I, no. 847/16.10.2006. Law no. 411/9.11.2006, published in the Official Gazette of Romania, Part I, no. 949/24.11.2006. Law no. 420/22.11.2006, published in the Official Gazette of Romania, Part I, no. 968/4.12.2006).

^{lxviii} The Official Gazette of Romania, no. 842, the 19th of September 2005.

^{lxix} The National Anticorruption Directorate was set up **ab initio** to function at a national level, as a part of the Public Prosecutor's Office attached to the High Court of Cassation and Justice, as an autonomous Public Prosecutor's Office, specialized on fighting against corruption acts (initially named National Anticorruption Public Prosecutor's Office) by Government Emergency Ordinance no. 43/2002, approved by Law no. 503/2002, subsequently altered and adnotated by Government Emergency Ordinance no. 24/2004, also approved by Law no. 601/2004 (the Official Gazette of Romania no. 1227, 20th December 2004) and more recently, by Law no. 247/2005 passed in order to alter and complete Law no. 304/2004 on organizing the judiciary and then by the Government Emergency Ordinance no. 134/2005, by Law no. 54/2006 (the Official Gazette of Romania no. 226, 13th March 2006), having an autonomous structure, its own judicial status within the Public Prosecutor's Office

attached to the High Court of Cassation and Justice; later on the National Anticorruption Public Prosecutor's Office was reorganized and initially transformed into a department to finally become a directorate (as it actually is today). The National Anticorruption Directorate performs its powers all over Romania having specialized prosecutors whose aim is to fight against corruption; it has jurisdiction – according to article 13 in the Government Emergency Ordinance no. 43/2002 – for most of the offences provided by Law no. 78/2000 with a view to prevent, identify and sanction corruption acts, by taking into consideration not only the material damage caused or the value in money of the good which is regarded as the object of the corruption act, but also the quality of the person (the supposed offender). According to article 3 in the Government Emergency Ordinance no. 43/2002, altered by Law no. 54/2006, the main power of NAD is to initiate the criminal prosecution process, under the conditions provided by the Code of Criminal Procedure, in conformity with Law no. 78/2000 on preventing, identifying and sanctioning corruption acts and in the actual Government Emergency Ordinance, for the offences provided by Law no. 78/2000 which come in NAD jurisdiction according to article 13; for exercising these powers NAD may use special means for analysing offence acts, which are derogatory from the common law norms, from among those authorised by special laws in corruption matters, thus creating a special criminal procedure and judgement for corruption offences or for corruption related acts.

^{lxx} This text separates DIOCTO competence not only from the common one, which is specific for ordinary Public Prosecutor's Offices, attached to the courts of justice, but also from another type of competence, a special one, which is specific for NAD, according to article 13 in the Government Emergency Ordinance no. 43/2002; in conformity with this article NAD competence is privileged - as special legislation points out, and thus DIOCTO has competence over certain offences, as article 12 points out: „with the exception of those assigned to NAD”. This actually points out the dimensions that special procedure has, thus making up a new criminal procedure that coexist with common criminal procedure and that can be used whenever it comes to one of the offences that, according to law, refer to organized crime or terrorism. By this regulation, it has been attempted to make a clearer delimitation from NAD competence, not only as far as the quality of the person is concerned (criterion specific for NAD competence) but also as far as the material evidence is concerned, considering that both structures have a special material competence and have a similar rank. (see **I.C. Spiridon**, *Considerații referitoare la Legea no. 39/2003 privind prevenirea și combaterea criminalității organizate*, Dreptul no. 3/2008, p. 174).

^{lxxi} The Official Gazette of Romania, no. 842, the 19th of September 2005.

^{lxxii} The Official Gazette of Romania, no. 751, on the 6th November 2007.

^{lxxiii} In this respect, it is relevant the fact that in conformity with article 2. (2) of the Government Emergency Ordinance no. 123/2007, the national member of Eurojust is appointed by the Ministry of Justice from among the prosecutors with experience in fighting against serious forms of organized crime, corruption or terrorism.

^{lxxiv} The Official Journal of the European Union (JOUE) no. L 307, the 24th November 2007.

^{lxxv} The High Court of Cassation and Justice has been recently updated by the Law of Constitutional Revisions adopted in 2003, and thus, it became, by the reorganization of the Supreme Court of Justice, the supreme instance in Romania. The text of article 126. (3) from the revised Constitution explicitly sets forth the fact that the supreme instance mainly has the role to reinterpret the law and control that law is unitarily applied in all courts of justice. The High Court of Cassation and Justice makes use of its logic, the consequence of its casuistic solutions, and by means of the recourses made to the interest of law. The constitutional provision is pointed out in article 18. (2) of the Law no. 304/2004 with the subsequent modifications and adnotations, which reconfirm the constitutional power with which the High Court of Cassation and Justice is invested in order to ensure the interpretation and unitary application of the law by all the other courts of law. According to the law, the supreme instance performs this power in three ways: a) by solving the causes that come into its jurisdiction; b) by means of the recourses used to the interest of law, regulated in article 414², the Code of Criminal Procedure; c) by means of its practice in the other causes which are not brought before the High Court of Cassation and Justice as a recourse instance. This last way of interpreting and unitarily applying the law by the other courts of law is stipulated in article 27. (2) from the Law no. 302/2004, which provides that the President of the High Court of Cassation and Justice may agree for the judges to inform themselves at the courts of justice as to the aspects concerning the correct and unitary application of the law, by making known the case law of the High Court of Cassation and Justice.

^{lxxvi} By article 146 let. (d) of the Constitution, exclusive competence of the Constitutional Court has been set forth as to «the objections of unconstitutionality of laws and ordinances brought before the courts of justice». Law no. 47/1992 (article 29. (1)) sets forth the same provision.

^{lxxvii} The Constitution of Romania was adopted in its initial form in the meeting of the Constitutive Assembly on 21.11.1991 and it was published in the Official Gazette of Romania, Part I, no. 233/21.11.1991. In 2003, the Constitution of Romania was altered and completed by the Law on the revision of the Constitution no. 429/2003 (the Official Gazette of Romania, Part I, no. 758/29.10.2003).

^{lxxviii} See Law no. 304/28.06.2004, republished in the Official Gazette of Romania, Part I, no. 827/13.09.2005.

^{lxxix} See **I. Neagu**, *Drept procesual penal. Partea generală. Tratat*, Global Lex Publishing House, Bucharest, 2007, p. 98.

^{lxxx} This obligation is provided in article 70. (2), the Code of Criminal Procedure, as well as in article 250 (1. a), the Code of Criminal Procedure. We point out the fact that in the previous text of Law no. 356/2006, the defendant was to be informed only of the deed that makes the object of the criminal investigation, and that there were no references as to the judicial framing of the deed committed.

^{lxxxi} See **I. Neagu**, *op.cit.*, p. 106-108; **N. Volonciu**, *Tratat de procedură penală. Partea generală*, Paideia Publishing House, Bucharest, s.a., p.126-129; **Gr.Theodoru**, *Tratat de drept procesual penal*, Editura Hamangiu, București, 2007, p. 65-67; **Gh.Mateuț**, *Tratat de procedură penală. Partea generală, vol. I*, C.H.Beck Publishing House, Bucharest, 2007, p. 238-243.

^{lxxxii} Law no. 356/21.07.2006 on altering and completing the Code of Criminal Procedure was published in the Official Gazette of Romania, Part I, no. 677/7.08.2006.

^{lxxxiii} Before the Law no. 356/2006 was passed, article 322 of the Code of Criminal Procedure used to have the following provisions: The president orders that the clerk read the act informing the instance, after which he explains to the defendant the blame for which he is made responsible. At the same time he clarifies to the defendant his right to ask the co-defendants, the other parties, the witnesses and experts questions, as well as to give explanations whenever he thinks necessary during the judicial investigation.

^{lxxxiv} See, **I. Muraru**, *Drept constituțional și instituții politice*, Proarcadia Publishing House, vol. I, Bucharest, 1993, p. 229; **I. Deleanu**, *Drept constituțional și instituții politice*, Tratat, vol. II, Europanova Publishing House, Bucharest, 1996, p. 117.

^{lxxxv} The Constitutional Court has decided that the disposition provided in the former Law on the organization of the judiciary - according to which the Supreme Court of Justice is held responsible for ensuring a unitary judicial practice - corresponds to the constitutional principle according to which all citizens are equal before the law and public authorities. The Constitutional Court motivated its decision as follows: on the one hand, any law is unique, and consequently it can not be differently applied from one court to another [Decision no. 58/1997 (the Official Gazette of Romania no. 90, 26th February 1998)]; on the other hand, the principle of equality before the law includes in its normative content the unitary character of its applicatin in relationship with the territory [Decision no. 4/1992 (the Official Gazette of Romania no. 182, 30th July 1992)].

^{lxxxvi} Analysing the Europene Court of Human Rights case law - as to the principle of non-discrimination - one can notice that case law used in this court is subordinated to all the Convention clauses, which safeguard individual rights and freedoms, so that the Convention can be invoked any time there is a fear that a normative disposition is not observed, and discrimination presents itself as an extenuating circumstance (D. Micu, *op. cit.*, p. 127).

^{lxxxvii} Similarly, **S.E. Tănăsescu**, *Principiul egalității în dreptul românesc*, Publishing House All Beck, Bucharest, 1999, p. 247.

^{lxxxviii} See **J.C. Soyer, M. de Salvia**, in **L.E. Pettiti a.a.**, *La Convention europeenne des droits de l'homme*, Economica Publishing House, Paris, 1995, p. 265.

^{lxxxix} In applying this principle, the Court in Strasbourg has established that every party is entitled to bring counterarguments to the arguments expressed by the other party (C.E.D.O., 29th May 1986, Feldbrugge c. the Netherlands, in V. Berger, *op. cit.*, p. 235). In the trial Bonisch v. Austria on 6th May 1985 (V. Berger, *op. cit.*, p. 254) s-a hotărât că trebuie audiați martorii și experții ambelor părți.

^{xc} The Constitutional Court, Decision no. 73/1996, apud S.E. Tănăsescu, *cit. w.*, p. 248.

^{xci} At present, recourse in cancellation is implicitly abolished, since it is no longer stipulated in Law no. 304/2004 on the organization of the judiciary, and by Law no. 576/2004 it is eliminated from the Romanian judiciary system, by the repealing of the provisions stipulated by article 409-414¹ from the Code of Criminal Procedure on recourse in cancellation.

^{xcii} At present, article 254 (1), the Code of Criminal Procedure is appropriately altered by Law no. 281/2003.

^{xciii} See the Constitutional Court, Decision no. 294/2002 (the Official Gazette, no. 891, the 10th of December 2002).

^{xciv} Ibidem.

^{xcv} Ibidem.

^{xcvi} The Official Gazette of Romania, no. 136, the 1st April 1999.

^{xcvii} Personal competence is derogation from material competence and it is that form of competence which is determined by the quality that the offender has when he commits the offence.

^{xcviii} The Official Gazette of Romania, no. 22, 21st January 1999.

^{xcix} The Official Gazette of Romanian, no. 1052, the 12th of November 2004.

^c The exercise of certain rights or freedoms may only be restricted by law, and only if necessary, as the case may be, for: the defence of national security, of public order, health, or morals, of the citizens' rights and freedoms; conducting a criminal investigation; preventing the consequences of a natural calamity, disaster, or an extremely

severe catastrophe. Such restriction shall only be ordered if necessary in a democratic society. The measure shall be proportional to the situation having caused it, applied without discrimination, and without infringing on the existence of such right or freedom.

^{ci} Thus, according to article 226 from the Code of Criminal Procedure, for unjustified absence (article 331 The Criminal Code), desertion (article 332 the Criminal Code), Transgression of orders (article 333 C.p.), insubordination (article 334 C.p), eluding military service (article 348 the Criminal Code.), eluding recruitment (article 353 the Criminal Code), respectively failure to present oneself for incorporation or concentration (article 354, the Criminal Code), the criminal prosecution may be initiated only at the commanding officer's request.

^{cii} For example, in conformity with article 177. (7) of the Code of Criminal Procedure, the militaries are summoned at the unit where they belong, through their commander. At the same time, in conformity with article 184. (4), the Code of Criminal Procedure, enforcement of the orders of appearance regarding the militaries is done through the commander of the military unit or the garrison.

^{ciii} See Law no. 302/2004 on international judicial cooperation on criminal matters, published in the Official Gazette of Romania, Part I, no. 594/01.07.2004.

^{civ} The undercover investigator body is also regulated in special laws on serious offences, such as Legea no. 678/21.11.2001 on the prevention and the fight against traffic with persons (the Official Gazette of Romania, Part I, no. 783/11.12.2001); Law no. 218 on the 23rd April 2002 on the organization and functioning of the Romanian Police (The Official Gazette of Romania, Part I, no. 305/9.05.2002); Law no. 39/21.01.2003 on preventing and fighting against organized crime (the Official Gazette of Romania, Part I, no. 50/29.01.2003).

^{cv} See Law no. 51/ 29.07.1991 on national security of Romania, published in the Official Gazette of Romania, Part I, no. 163/7.08.1991.

^{cvi} The Official Gazette of Romania, no. 219, 18th May 2000.

^{cvi} The Official Gazette of Romania, no. 333, 30th April 2008.

^{cvi} See Law no. 302/28.06.2004 on international judicial cooperation for criminal matters, published in the Official Gazette of Romania, Part I, no. 594/01.07.2004).

^{cix} More than that, before 2003 domicile search – in case there is a flagrant offence – could also be made judicial police bodies, without the prosecutor's consent.

^{cx} In some instances, the administrative subordination of the judicial police investigation bodies has been completely eliminated. We refer to article 10. (7) from the Government Emergency Ordinance no. 43 /2002 on the National Anticorruption Directorate, according to which officers and agents from Judicial Police of NAD **may not receive from their hierarchically superior bodies any task.**

^{cx} See Government Emergency Ordinance no. 43/4.04.2002 on the National Anticorruption Directorate, published in the Official Gazette of Romania, Part I, no. 244/11.04.2002, subsequently modified and completed for several time.

^{cxii} See Law no. 508/17.11.2004 on the setting up, organization and functioning of the DIOCTO within the Public Ministry, published in the Official Gazette of Romania, Part I, no. 1089/23.11.2004, subsequently modified and adnotated.

^{cxiii} These dispositions are not applied in relationship with the states who are parts to the Convention for applying the Schengen agreements. As to these states, the following conditions are imposed for meeting the requirements of the rogatory commissions whose object is represented by searches or seizures: a) Romanian legislation and the legislation of the solicited state will provide a punishment for the deed which determined the request for a rogatory commission. This punishment will deprive of liberty the offender. A safety measure which restrains liberty will also be provided, and its maximum term is of at least 6 months. Another possibility is for the legislation of one of the parties to provide a countersanction, while in the legislation of the other party the deed will be punished as a breach of the judicial norms, identified by administrative authorities whose decision may be attacked with recourse before a competent criminal court; b) the actions of the rogatory commission must be compatible with the Romanian law.

^{cxiv} Extradition of a person may be required only if the deed - for which the person solicited for extradition is accused or was convicted - is defined as an offence both by the law of the soliciting state, and by the Romanian law. By derogation, the deed need not be defined as an offence in the soliciting state law, if for that deed double criminality is excluded by an international convention to which Romania is part. Extradition may be required from Romania, in order to enforce criminal prosecution or initiate the trial, for deeds whose committal determines – according to Romanian legislation and the other state's legislation – a punishment with imprisonment of at least 1 year, and with a view to serve a punishment, only if this is of at least 4 months (article 28 of the Law no. 302/2004 on international judicial cooperation on criminal matters).

^{cxv} The Official Gazette of Romania, no. 964, 28th December 2002.

^{cxvi} See **Gh. Mateuț**, *Protecția martorilor. Utilizarea martorilor anonimi în fața organelor procesului penal*, Lumina Lex Publishing House, Bucharest, 2003, p. 24-25.

^{cxvii} The Official Gazette of Romania, no. 826, the 13th of September 2005.

^{cxviii} The content of internal procedure regulations, of the ones included in the Code of criminal procedure, as well as of the ones provided by the special laws, reveal, as we shall see, the fact that special procedural measurements adoption is conditioned by the existence of solid data or evidence or solid and palpable evidence, as the case may be, concerning the “preparation or committal of an offence”. (see **N. Volonciu, A. Barbu**, *Codul de procedură penală comentat. Article 62-135, Probele și mijloacele de probă*, Ed. Hamangiu, București, 2007, p. 127 și urm.)

ENTROPY IN ECONOMICS: ITS MEASUREMENT THROUGH PRIMARY DATA AND ITS USEFULNESS IN BUSINESS

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Abstract

Since Georgescu-Roegen's ("The entropy law and the economic process", 1971) pioneering work on entropy in economics, not many scholars have preoccupied themselves with this concept and its consequences. Recently some revival is taking place to link entropy and the business world (see for example "The entropy vector, connecting science and business" by Handscombe and Patterson, 2004).

Briefly entropy is the degree of disorder at some time for any system. For a closed system the natural tendency would be for entropy to keep increasing till final destruction. In the business world, entropy is also present and unless some actions are taken, any business will become more and more ineffective and eventually die. Sanidas ("The open system of four dynamic bio-socio-economic processes of the firm: the diamond of the black box", 2006) has introduced four processes ("processes of the black box, or PROBB) that are negentropic, in other words they can prevent entropy from increasing during all operations of a firm.

Based on Sanidas's work a questionnaire has been constructed and a survey was conducted with 120 firms in the marine industry in Australia. In this paper part of the results of this survey is presented with the aim to measure entropy in business. Thus, variables that denote waste directly or indirectly are some of the variables to correlate with all variables in the PROBB and inspect which such correlations are the strongest. The examination of these correlations together with some other analyses is providing us with some encouraging results as to the measurement of entropy. In turn such measurement will enable us to establish which areas are primary sources of inefficiencies. Obviously, the detection of these inefficiencies is necessary for firms to become more competitive and robust in their commercial and production activities.

Key words: *entropy, waste, measurement, firms*

Introduction

Since Georgescu-Roegen's (1966, 1971) pioneering work on entropy in economics¹, several scholars have preoccupied themselves with this concept and its consequences. Recently some revival is taking place to link entropy and the business world; see for example Handscombe and Patterson's (2004) paper as a general and simple exposition of the issue; Khalil (2004) who made an overall critique of Georgescu-Roegen's work; Smith and Foley (2008) who rigorously demonstrated the links between entropy and economic general equilibrium theory; Ayres (1994) who related entropy to many aspects of information, economics, evolution, and progress. Briefly, entropy is the natural universal process according to which there is a tendency for wasting energy so that increasing disorder and decreasing efficient productive work takes place in a system unless some actions occur that slow down this process. Handscombe and Patterson (2004, p. 1) define entropy very simply as "the degree of disorder or chaos that exists or is created". Thus, "entropy in a closed system must remain constant or increase" (Moore, 2007, p. 38).

¹ A good summary of this author's significant work can be found in Maneschi and Zamagni (1997).

From Handscombe and Patterson, (2004), we can isolate some variables to represent entropy in business (see Table 1). Note that these variables although included in one of the three categories (columns in Table 1) can also be used in the other categories but in the opposite direction. Thus an entropy-increasing variable can also be an entropy-decreasing variable in a different context. A good example is leadership which can generate decisions that are either entropy-decreasing or the contrary. It would be useful to quote these authors for some of these variables.

Business plans provide a way of trying to think ahead in order to organize (i.e. minimize) disorder in the way that a business is developed (ibid, p. 134).

A company's ability to change is determined by its vision multiplied by its leadership and resources, all divided by the corporate age (ibid, p. 20); the corporate age is the inertia to do with culture, attitude, procedures, practices (ibid, p. 20).

Information must be considered as a negative term in the entropy of a system...We have only partial information and entropy measures the lack of information (ibid, p. 28).

The entropy vector encourages us to realize that the lack of setting broad tolerances is as important as setting the specific objectives (ibid, p. 44).

Experience curve, which is simply the continuous resetting of the entropy vector (ibid, p. 46).

A lack of collaboration can be equated with entropy (ibid, p. 85).

And so on.

Table 1 Entropy-related factors/variables in conducting business

| Increasing entropy | Decreasing entropy | Increasing or decreasing entropy |
|---------------------------|---------------------------|---|
| Waste | Innovations | Culture |
| Inertia | Experience | Attitudes |
| Lack of information | Vision | Procedures |
| Decreasing constraints | Leadership | Risk taking thinking |
| Deregulation | Tolerance | |
| Lack of collaboration | Objectives | |
| Stress level | Production line | |
| Fatigue | Knowledge | |
| Conformity/convention | Links with outside | |
| Uncertainty | Planning | |

The aim of this paper is to check whether these factors (and others) as seen in Table 1 are important indeed in a real case. We will use as a real case a sample of 80 firms² from the marine industry in Australia (the survey was conducted during 2006 and 2007). For this purpose, we need a theoretical model which will help us to properly analyse the above real case in order to detect any signs of entropy. Recently Sanidas (2005, 2006) has introduced a comprehensive model of describing and explaining a firm's dynamic path in the economy. This model includes –in a succinct way- all major factors that shape the firm's evolution in

² By now 120 firms have been surveyed but the extra 40 on top of the 80 are not included in the analysis of this paper due to time limitations.

growth. The theory of the firm is extended to encompass all types of opportunity costs and not just transaction costs. As a further extension to the transaction costs and capabilities development and as a synthesis of several related issues, Sanidas (2006) has introduced a complete system of 4 mutually exclusive, interdependent and negentropic³ processes (PROBB) that fully describe the contents of the black box⁴ of production (see Table 2). This model as Table 2 shows is a comprehensive summary of all elements that uniquely describe and explain the way firms are organized, managed and grow. These four PROBB are interdependent, although each PROBB contains unique elements that cannot belong to another PROBB.

The important point to notice in this Table 2 with the PROBB variables is that each one of them represents opportunity costs. Thus, the POC variables represent transaction (or friction) costs, the POS elements stand for strategic opportunity costs, the POW variables express wisdom costs and the POM factors generate kinetic costs. All these different types of opportunity costs contribute to the natural law of entropy. However, it must be reminded that the PROBB variables can be both entropy-increasing and entropy-decelerating depending on how they are used in a business context. This will also be the object of investigation in the present paper.

Table 2 The complete four processes of the black box (PROBB)

| P O W | P O S | P O M | P O C |
|--|------------------------------------|---|---|
| Process of wisdom | Process of strategies | Process of movements | Process of contracts |
| Power | Survival | Infrastructure | Superstructure |
| Ability and memory | Initiatives for action | Movement relations between the TIOP | Rules of the relations between the TIOP |
| Wisdom costs* | Strategic costs | Kinetic costs | Transaction costs |
| Purpose*: to decrease 'negative' * knowledge | Purpose: to produce fewer mistakes | Purpose: to produce less waste* | Purpose: to produce less friction |
| Potential energy | Reaction energy | Kinetic energy | Friction energy |
| Experience | Strategies | Timing | Contracts with employees* |
| Tacit knowledge | Everyday decisions* | Kinetic Procedures (e.g. in just-in-time) | Legal form of the firm |
| Education and training | Planning | Kinetic routines | Contracts with suppliers* |
| Culture and aesthetics | Vision | Layout | Contracts with customers |
| Information and data | Mission | Transport | Contracts with society |
| Competences and capabilities* | Objectives | Teamwork | Legal standards |
| R&D* | Attacks | Kinetic coordination (harmonization) | Accounting rules |
| Imitation | Defense | Implementation | Institutions |
| Innovations* | Inertias | Execution | Governance |

³ "Negentropic" means that the effect on entropy is negative, hence the underlying processes have the tendency to slow down increases in entropy or even to decrease entropy.

⁴ The term "black box" was coined by Coase (1992), the Nobel Prize laureate who introduced transaction costs in economics.

| | | | |
|--------------------------------------|------------------------------------|--|---|
| Leadership* | Momentum | Kinetic organization* | Trust* |
| POW | POS | POM | POC |
| Techniques of analysis | Entrepreneurship* | Effort non-physical | Standards |
| Needs* (e.g. for exploration) | Domination and Exploitation | Effort physical* | Authority |
| Motivation* | Initiatives | Fatigue | Control |
| Cognitive capacity and attention | Inspiration for action | Cooperation (actual kinetic) | Opportunism |
| Bounded rationality: Subjectivity | Decision making* | Work satisfaction as a team | Supervision rules |
| Idiosyncrasy | Forecasting | Kinetic tasks | Incentives |
| Attitudes and beliefs* | Uncertainty | Ergonomics | Functions |
| Marketing intelligence* | Mistakes | Logistics | Autonomy |
| Sophistication | Policies | Problem solving* | Negotiations |
| Socio-Psychological states* | Organizational defensive routines* | Mechanisms of feedback* | Documentation |
| Explicit knowledge | Risk | Performance | Ownership rules |
| Design of products | Reactions to fortuitous events | <i>Ad hoc</i> non-routine movements | Informal rules |
| POW | POS | POM | POC |
| Operations research techniques | Readiness and emergence* | Operations research applications (e.g. PERT) | Conventions |
| Intuition*, impressions, perception* | Interpretation and judgment | Work rationalization (e.g. scientific) | Conflict solutions |
| Organizational spirit* and capital | Sense making* | Location | Communications rules |
| Imagination* and Afflatus | Improvisations and Heuristics* | Projects | Status |
| Unconscious* | Expectations | Transfer | Hierarchy |
| Illusions* | Will | | Form or structure of the firm (e.g. M-form) |
| Conception, insights | | | Equity |
| Subconscious and emotions* | | | |
| Utility versus virtue* | | | |

*For the terms with an asterisk see Appendix 2 of Sanidas, 2006. Source: Sanidas (2006).

The remaining of the paper will be as follows. Section 2 will introduce methodology and present the results; and section 3 will discuss conclusions.

Methodology and results

The model PROBB contains about 150 variables out of which about 120 are directly related to the elements of Table 2 above, and the remaining are more performance or economics related. The former will be called the X, Y, Z, and W PROBB variables

corresponding to the four processes respectively (POS, POW, POM, and POC); whereas the latter will be called the V variables. They are:

- V1: Customers dictate terms and requirements (the opposite of the 7-score Likert scale would be: we, the firm, dictate these terms)
- V2: Suppliers dictate terms and requirements (as for V1)
- V3: Rivals are weak (strong):
- V4: Power we, the firm, have in dictating prices and/or quantities
- V5: Low cost strategy (low, high)
- V6: Low price strategy (low, high)
- V7: Niche market strategy
- V8: Product quality
- V9: Product uniqueness
- V10: Availability of large market for our product
- V11: Adoption of technical innovations
- V12: Creation of technical innovations
- V14: Technology choice affected company operations (low, high)
- V15: Company operations affected technology choice
- V21: Sales growth in the last 5 years

These V variables represent the consequences of the importance and direction of all PROBB variables. Thus we would expect that some PROBB variables-for a given firm- are rather negative in their action towards the Vs. Those PROBB variables that are not well related to Vs -for a given firm- can be termed the potentially entropy increasing and those PROBB variables that are well related to Vs can be termed the potentially entropy decreasing.

First we can test the impact of each PROBB variable on the totality of the Vs. Second, later further below, we will test the impact of each PROBB variable on each individual V. Thus we first need a test that testifies the impact of a given PROBB variable on the totality of the V variables. Such a test is the Bartlett test of sphericity usually used in factor analysis. It shows how well all variables in a group are correlated with each other. It is calculated as a chi-square test. The way to use this test in our study is as follows: first we calculate the Bartlett chi-square for all V variables only. This value is 1789. Then we calculate the same test by adding to all V variables a PROBB variable. The increment in chi-square will obviously indicate how well the PROBB variable is correlated with all V variables together. According to the Bartlett test and the procedure just described, Table 3 shows the distribution of calculated chi-square for all PROBB variables.

Table 3 Bartlett test for the impact of each PROBB variable on all Vs

| Value of chi-square | Absolute frequency of PROBB elements | Relative frequency | Cumulative frequency (%) |
|---------------------|--------------------------------------|--------------------|--------------------------|
| 1880 (category A) | 10 | 9.2 | |
| 1903 (category B) | 10 | 9.2 | 18.3 (up to 1903) |
| 1930 | 24 | 22.0 | |
| 1965 | 23 | 21.1 | |
| 2003 | 23 | 21.1 | 64.2 (1930 to 2003) |
| 2035 (category C) | 9 | 8.3 | |
| 2200 (category D) | 10 | 9.2 | 17.4 (2035 to 2200) |

Table 4 shows the lowest (A and B categories) and highest (C and D categories) performance (as chi-square) of individual variables in being correlated with the basic performance variables Vs (considered in their totality).

Table 4 Lowest and highest chi-square (Bartlett test) for PROBB variables

| | A | | B | | C | | D |
|----------------|-------------|-----|-------------|-----|-------------|-----|-------------|
| x10 | 1872 | x26 | 1903 | x12 | 2011 | x1 | 2039 |
| x23 | 1875 | y21 | 1885 | x17 | 2031 | x9 | 2046 |
| z19 | 1861 | y40 | 1902 | y17 | 2030 | x13 | 2124 |
| z22 | 1846 | z15 | 1887 | z25 | 2013 | y15 | 2109 |
| z29 | 1861 | z32 | 1890 | z28 | 2014 | y36 | 2040 |
| z34 | 1869 | z35 | 1903 | z33 | 2004 | y44 | 2063 |
| z36 | 1876 | w15 | 1892 | w1 | 2031 | z16 | 2051 |
| w16 | 1862 | w22 | 1890 | w2 | 2012 | w7 | 2042 |
| w32 | 1850 | w29 | 1889 | w3 | 2027 | w13 | 2076 |
| w33 | 1862 | w31 | 1882 | | | w25 | 2045 |
| <i>average</i> | <i>1863</i> | | <i>1892</i> | | <i>2019</i> | | <i>2064</i> |
| <i>median</i> | <i>1862</i> | | <i>1890</i> | | <i>2014</i> | | <i>2049</i> |

Note: Categories A and B are the least related to the V variables hence they are the least-decreasing categories of entropy. Categories C and D are the most related to the Vs hence they are the most decreasing categories of entropy.

For the A category we have the following PROBB variables as seen in Table 4.

X10: inertia
X23: interpreting surroundings
Z19: achievement of production routines
Z22: well defined tasks that involve movements
Z29: fatigue
Z34: location
Z36: careful implementation of production operations
W16: status (hierarchy) hindering management
W32: management resolving conflict
W33: equity (vital/crucial)

An inspection of these PROBB variables shows that it makes sense that they are not well correlated with the group of V variables. Thus, for example, “inertia”, “fatigue”, “status”, and “conflict resolving” do not offer a substantial amount of information in promoting the Vs. Each one of these 10 PROBB variables is not capable in reducing or slowing down entropy and hence entropy will follow its natural tendency to increase.

For the B category we have the following PROBB variables as seen in Table 4.

X26: uncertainty
Y21: culture in company influencing relationships in the firm
Y40: accumulated knowledge or ad hoc processes enhancing innovations
Z15: frequency of usage of OR (operations research) methods
Z32: layout
Z35: harmonization/coordination of production activities
W15: demarcation of functions
W22: structure of firm (e.g. departmental) assisting management
W29: selfish staff more than expected by upper management
W31: staff negotiations with management

Whatever we said about the category A PROBB variables we can also say about these B category variables but to a lesser degree. In addition, for both A and B categories we can see that many of their corresponding PROBB variables are approximations or representations for entropy factors as mentioned in Table 1 above: uncertainty, inertia, lack of collaboration, and so on. This can be seen more precisely in Table 5.

Table 5 Correspondence between some entropy-related and PROBB variables (part 1)

| Inertia | Lack of information | Decreasing constraints | Lack of collaboration | Stress level | Conformity | Uncertainty | procedures |
|---------|---------------------|------------------------|-----------------------|--------------|------------|-------------|------------|
| X10 | X23 | W33 | W29 | Z29 | Y21 | X26 | Z19 |
| Z32 | Z15 | | W31 | | W15 | Y40 | Z22 |
| Z34 | | | W32 | | W16 | | Z35 |
| W22 | | | | | | | Z36 |

For the C category we have the following PROBB variables as already indicated in Table 4.

X12: entrepreneurship versus cautious type of management
X17: exploring large markets to secure a large market share
Y17: marketing intelligence
Z25: non-routine versus routine activities (valuable)
Z28: monitoring physical efforts
Z33: using ergonomics
W1: detailed and rigorous contracts with employees
W2: detailed and rigorous contracts with suppliers
W3: detailed and rigorous contracts with customers

For the D category we have the following PROBB variables as already indicated in Table 4.

X1: using formal strategies
X9: defence in the market
X13: initiatives with far reaching consequences
Y15: mental and thinking capacities
Y 36: self-interest versus altruism of staff as a group
Y44: replication by other firms of your knowledge of products and services
Z16: using methods to rationalize work
W7: traditions and institutions of staff members
W13: company form (e.g. Pty) affecting functioning of the firm
W25: using and applying control measures

For both the C and D categories we can see that many of their PROBB variables are good proxies for the variables in Table 1 that are considered to reduce or slow down entropy. Thus, W1, W2, W3, W13, and W25 increase constraints on the system: this is exactly what a system needs in order to slow down entropy as was mentioned above regarding the variables of Table 1. In Table 6 we complete the correspondence between the PROBB variables of categories C and D and the variables affecting the slow down of entropy as per Table 1.

Table 6 Correspondence between some entropy-related and PROBB variables (part 2)

| Increasing constraints | Experience | Leadership | Tolerance | Stress level | Production line | Knowledge | Links with outside | Planning |
|------------------------|------------|------------|-----------|--------------|-----------------|-----------|--------------------|----------|
| W1 | W7 | X12 | Y36 | Z28 | Z16 | Y15 | Y44 | X1 |
| W2 | | X13 | X9 | Z33 | Z25 | Y17 | | X17 |
| W3 | | | | | | | | |
| W13 | | | | | | | | |
| W25 | | | | | | | | |

Table 7 shows the distribution of the four PROBB in terms of the four categories of entropy impact as described in Table 2.

Table 7 PROBB categories and entropy related intensity

| Entropy category | POS | POW | POM | POC | Total |
|--|----------|----------|-----------|-----------|-----------|
| A: most increasing | 2 | 0 | 5 | 3 | 10 |
| B: increasing (less than in A) | 1 | 2 | 3 | 4 | 10 |
| Total A and B: increasing (or least decreasing) | 3 | 2 | 8 | 7 | 20 |
| C: decreasing | 2 | 1 | 3 | 3 | 9 |
| D: most decreasing (more than in C) | 3 | 3 | 1 | 3 | 10 |
| Total A and B: decreasing (or slowing down) | 5 | 4 | 4 | 6 | 19 |
| Grand total (A+B+C+D) | 8 | 6 | 12 | 13 | 39 |

From Table 7 we can see that the POC is heavily represented in both the increasing and decreasing PROBB variables. The POM is only mostly present in the entropy-increasing categories. From the PROBB model viewpoint, this means that kinetic (POM) and friction (POC) energies are mainly responsible for affecting entropy in a substantial way.

Now we turn to the testing of the impact of each PROBB variable on each V variable separately. Thus it remains to see which PROBB variables are most correlated with the performance variables Vs. Table 8 shows the results.

Table 8 Significant correlations between PROBB variables and V variables

| | V1 | V2 | V3 | V4 | V5 | V6 | V7 | V8 | V9 | V10 | V11 | V12 | V14 | V15 | V21 | total |
|----|----|----|----|----|----|----|----|----|----|-----|-----|-----|-----|-----|-----|-------|
| X1 | | | | * | | | | | | | * | | * | * | * | 5 |
| X2 | | | | | | * | | | | | * | | | | * | 3 |
| X3 | | | | * | | | * | | | | | | | * | | 3 |
| X4 | | | | * | | | | | | | | | | | * | 2 |
| X5 | | | | * | | | | | | | | | | | * | 2 |
| X6 | | | | * | | * | | | | | | | | | * | 3 |
| X7 | | | | | * | | * | | * | | * | * | | | | 5 |
| X8 | | | | | | | | | * | | * | * | | | * | 4 |

| | | | | | | | | | | | | | | | | |
|-----------|----|----|----|----|----|----|----|----|----|-----|-----|-----|-----|-----|-----|-------|
| X9 | | | | * | | | * | | * | | * | * | | | * | 6 |
| X10 | | | | | | | | | | | | | | | | 0 |
| X11 | * | | * | | | | | | | | | | | | | 2 |
| X12 | | | | | | | * | | * | | * | | | * | * | 5 |
| X13 | | | * | * | | | * | * | * | | * | * | | * | * | 9 |
| X14 | * | * | | * | | | * | * | | | | | | | | 5 |
| X15 | * | | | | * | | | | * | | * | | * | * | | 6 |
| X16 | | | | | * | * | * | | * | | | | | | | 4 |
| X17 | | | | * | | | | | * | * | | * | | | | 4 |
| X18 | | | | | | | | | | | | | | | | 0 |
| X19 | | | | * | | | * | | | | * | | * | * | * | 6 |
| X20 | | | | | | | | | | * | | | | | | 1 |
| X21 | | * | | * | | * | | | | | | | * | * | * | 6 |
| X22 | | | | * | | | | | | | | | | | | 1 |
| X23 | | * | | | | | | | | | | | | | | 1 |
| X24 | * | | | | | | * | * | | | | | | | | 3 |
| X25 | | | * | * | | | | | | | | | * | * | | 4 |
| X26 | | | * | | | | | | | | | | | | * | 2 |
| X27 | | | * | | | | * | | * | | * | * | | | * | 6 |
| TOTAL POS | 4 | 3 | 5 | 13 | 3 | 4 | 10 | 3 | 9 | 2 | 10 | 6 | 5 | 8 | 13 | |
| | V1 | V2 | V3 | V4 | V5 | V6 | V7 | V8 | V9 | V10 | V11 | V12 | V14 | V15 | V21 | total |
| Y7 | | | | * | | | | | * | | * | * | | * | | 5 |
| Y8 | * | | | | * | * | | | | | | | | | | 3 |
| Y13 | | * | * | | | | | | | | | | | | | 2 |
| Y14 | | | | | * | | | | | | | | | | | 1 |
| Y15 | | | | * | | * | * | | * | * | * | * | | | * | 8 |
| Y17 | | | | | | | * | | * | | * | * | | | | 4 |
| Y18 | * | | | | | | * | | | | | | | | | 2 |
| Y19 | | | | * | | | * | | * | | * | * | | | | 5 |
| Y20 | | | | | | * | * | | * | | | | | | | 3 |
| Y21 | | | | | | | | | | | | | | * | | 1 |
| Y22 | | | | | * | | | * | * | | | | | | | 3 |
| Y23 | | | | | | * | | | * | | | | | | | 2 |
| Y31 | | | | | | * | | | | | | | | | | 1 |
| Y32 | | | | | | | | | * | | | | | * | | 2 |
| Y33 | | | | | | | * | | * | | | | * | | | 3 |
| Y34 | | | * | | | * | | | * | | | | | | | 3 |
| Y35 | * | | | | | | | | * | | | | | | | 2 |
| Y36 | | | * | | | * | | | | | | | | | | 2 |
| Y38 | | | | | | | * | * | * | * | | | | | | 4 |
| Y39 | | * | | | * | | | | | | | | | * | | 3 |

| | | | | | | | | | | | | | | | | | |
|--------------|----|----|----|----|----|----|----|----|----|-----|-----|-----|-----|-----|-----|-------|---|
| Y40 | * | | | | | | | * | | | | | | | | | 2 |
| Y41 | | | | | | | | | | | | * | * | | | | 2 |
| Y42 | | | * | | | | | | | | | | | | | | 1 |
| Y43 | | | | | | | * | | * | | | | | | * | | 3 |
| Y44 | * | | * | | * | | | * | * | * | * | | | | * | | 8 |
| Y50 | | | | | | * | | | * | | | | | | | * | 3 |
| Y51 | | | | | | | | * | * | | | | * | | | | 3 |
| TOTAL POW | 5 | 2 | 5 | 3 | 5 | 8 | 9 | 4 | 16 | 3 | 5 | 5 | 3 | 6 | 2 | | |
| | V1 | V2 | V3 | V4 | V5 | V6 | V7 | V8 | V9 | V10 | V11 | V12 | V14 | V15 | V21 | total | |
| Z1 | | * | | | | | | | | | * | * | | | | | 3 |
| Z2 | | | | | | * | | * | | | | | | | | | 2 |
| Z15 | | | | | | | | | | | | | | | | | 0 |
| Z16 | | | * | | | | * | | | * | | * | | | | | 4 |
| Z17 | | | | * | | | | | | | | * | | | | | 2 |
| Z18 | | | | * | | | | | | | | | | | | | 1 |
| Z19 | | | * | | | | | * | | | | | | | | | 2 |
| Z20 | | | | | | | | | | | | | | | | | 0 |
| Z21 | | | | | | * | | | | * | | | | | | | 2 |
| Z22 | | | | | | | | | | | | | | | | | 0 |
| Z23 | | | | | | | * | * | | | | | | | | | 2 |
| Z24 | | | | | | | | | * | | * | * | | * | | | 4 |
| Z25 | | * | | | * | * | * | | | | | | * | * | | | 6 |
| Z26 | | | | | | | | | | | | | | | | | 0 |
| Z27 | | | | | * | | | | | | | | | | | | 1 |
| Z28 | | * | | | | * | * | * | | | * | | | | | | 5 |
| Z29 | | | | | | | | | | | | | | | | | 0 |
| Z30 | | | | | | | | | | | | | | | * | | 1 |
| Z31 | * | * | | | | | * | | * | | * | * | | | | | 6 |
| Z32 | | | | | | | | | | | | | | | | | 0 |
| Z33 | | | * | * | | | | * | | * | | | | | | | 4 |
| Z34 | | * | | | | | | | | | | | | | | | 1 |
| Z35 | | | | | | | * | | | | | | | * | * | | 3 |
| Z36 | | | | | | | * | * | | | | | | * | | | 3 |
| Z37 | | | * | * | | | | | | | | | | | * | | 3 |
| Z38 | | | * | * | | | | * | | | | | | | | | 3 |
| TOTAL POM | 1 | 5 | 5 | 5 | 2 | 4 | 7 | 7 | 2 | 3 | 4 | 5 | 1 | 4 | 3 | | |
| | V1 | V2 | V3 | V4 | V5 | V6 | V7 | V8 | V9 | V10 | V11 | V12 | V14 | V15 | V21 | total | |
| W1 | | | | | | | | | * | | * | | * | * | | | 4 |
| W2 | | * | * | * | | | | | | | | | | | | | 3 |
| W3 | | | | * | | | * | | | | | * | * | * | | | 5 |
| W4 | * | | | * | | | | | | * | | | | | | | 3 |

| | | | | | | | | | | | | | | | | |
|--------------------------------|----|----|----|----|----|----|----|----|----|-----|-----|-----|-----|-----|-----|-------|
| W5 | | | | | | | * | | * | | | | | | * | 3 |
| W6 | | | * | | | | * | | | | * | | | * | | 4 |
| W7 | | * | | | * | | | * | | * | | | | | | 4 |
| W8 | | * | | * | | | * | | | | * | * | | * | | 6 |
| W9 | | | * | | | | | * | | | | | | | | 2 |
| W10 | | * | | | * | * | | | | * | | | | | * | 5 |
| W11 | | | | | | * | | | | | | | | | | 1 |
| W12 | | * | | | | | | | | | * | * | | | * | 4 |
| W13 | | | | * | * | * | | * | | | | | | * | | 5 |
| W14 | | | * | | | | | | * | * | | * | | | | 4 |
| W15 | | | | | | | | | | | | | | | | 0 |
| W16 | | | | | | | | | | | | | | | | 0 |
| W17 | | | | | | | | | | | * | | | | | 1 |
| W22 | | | | | | | | * | | | | | | | * | 2 |
| W23 | * | * | | | | | | | * | * | * | | | | | 5 |
| W24 | | | | * | | | * | | | | * | * | * | * | * | 7 |
| W25 | | * | | | | | * | * | * | | * | * | | | | 6 |
| W26 | | | | | | * | | | * | | | | | | | 2 |
| W27 | | | | | | | | * | * | | | | | | | 2 |
| W28 | | | | | * | | | * | | | | | | | | 2 |
| W29 | * | | * | | | | | | | | | | | | | 2 |
| W30 | | | | | | * | | | | | | | | | | 1 |
| W31 | | | | | | | * | | * | | | * | | | | 3 |
| W32 | | | | | | | | | | | | | | | | 0 |
| W33 | | | | | | | | | | | | | | | * | 1 |
| TOTAL POC | 3 | 7 | 5 | 6 | 4 | 5 | 7 | 7 | 8 | 5 | 7 | 7 | 4 | 6 | 6 | |
| | V1 | V2 | V3 | V4 | V5 | V6 | V7 | V8 | V9 | V10 | V11 | V12 | V14 | V15 | V21 | total |
| GRAND TOTAL ALL PROBB | 13 | 17 | 20 | 27 | 14 | 21 | 33 | 21 | 35 | 13 | 26 | 23 | 13 | 24 | 24 | |

Notes: (i) For the definition of the remaining PROBB variables see Appendix 1. The correlation coefficients are usually between 0.10 and 0.30.

In Table 8 we can see that some variables V are more correlated with PROBB variables than other variables V. Thus, for example, V9 (product uniqueness) is significantly correlated with 35 PROBB variables. Or V1 (customers dictate terms and requirements) are significantly only correlated with 13 PROBB variables, and so on. These differences can be used to measure the degree of negentropy. Georgescu-Roegen (1966, p. 76) mentions Boltzmann's formula: $\text{entropy} = k \log n$, where k is a constant and n is the number of equivalent microstates. Handscombe and Patterson (2004, p. 38) use a simple example to demonstrate the meaning of Boltzmann's simplified formula: n can be for example 1 out of 5 (low entropy) possible patterns in an experiment or 1 out of 1000 (high entropy). Consequently in our case, an approximation of direct calculation of entropy would be for V7: $\text{entropy} = k \log 33/109 = -0.52k$, or for V2: $\text{entropy} = k \log 17/109 = -0.81k$. Thus, entropy for V2 is greater than entropy for V7 (by considering the absolute value), and so on.

In other words, the strategic/performance variable V2 is not sufficiently correlated with PROBB variables to guarantee low entropy as is the case with V7. This is the case for the sample of 80 firms surveyed in the marine industry in Australia, and another survey in a different sector might yield different results. As Georgescu-Roegen (1966, p. 78) sums it up for Boltzmann's formula⁵: "If the higher the disorder the greater is the probability of its occurring, then obviously any closed system –such as nature – has a tendency to pass from any state to one of higher disorder".

Table 9 summarizes the results of Table 8 in terms of the four PROBB and total. We can see -in this way- what the effect is of each PROBB on the V variables. Some of these effects will be discussed in the last section below. Thus, for example, the POS is the most influential entropy-wise on V11 (10 significant correlations), and so on.

Table 9 Summary of the effects of the four PROBB on individual Vs

| | V1 | V2 | V3 | V4 | V5 | V6 | V7 | V8 | V9 | V10 | V11 | V12 | V14 | V15 | V21 |
|--------------|----|----|----|----|----|----|----|----|----|-----|-----|-----|-----|-----|-----|
| POS | 4 | 3 | 5 | 13 | 3 | 4 | 10 | 3 | 9 | 2 | 10 | 6 | 5 | 8 | 13 |
| POW | 5 | 2 | 5 | 3 | 5 | 8 | 9 | 4 | 16 | 3 | 5 | 5 | 3 | 6 | 2 |
| POM | 1 | 5 | 5 | 5 | 2 | 4 | 7 | 7 | 2 | 3 | 4 | 5 | 1 | 4 | 3 |
| POC | 3 | 7 | 5 | 6 | 4 | 5 | 7 | 7 | 8 | 5 | 7 | 7 | 4 | 6 | 6 |
| TOTAL | 13 | 17 | 20 | 27 | 14 | 21 | 33 | 21 | 35 | 13 | 26 | 23 | 13 | 24 | 24 |

These entropy-related computations for the Vs can be complemented with the frequency of each PROBB variable appearing in these computations. Thus, from Table 8 we can see that variables X13 appears 9 times as being significantly correlated with the Vs, Y15 appears 8 times, and so on. In this way we can determine once more which PROBB variables contribute to lowering entropy in the firms. Table 10 shows the most entropy-decreasing and the least entropy-decreasing PROBB variables.

Table 10 The most entropy-decreasing and the least entropy-decreasing PROBB variables (in affecting the Vs individually)

| | | | | | | | | | | | | | |
|--------------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Most | X13 | Y15 | Y44 | W24 | X9 | X15 | X19 | X21 | X27 | Z25 | Z31 | W8 | W25 |
| Least | X10 | X18 | Z15 | Z20 | Z22 | Z26 | Z29 | Z32 | W15 | W16 | W32 | Y14 | Y21 |

Note: For the most entropy-decreasing PROBB variables the frequency of significant correlations with Vs individually vary from 6 to 9 (mostly 6). For the least entropy-decreasing PROBB variables the frequency of significant correlations with Vs individually vary from 0 to 1 (zero for first 11 out of 13 in the Table)

We will finish this section by examining two special variables in the survey, those indicating waste of time (V*16) and negative emotions (V*20). Both these factors are a primary consequence of entropy increasing in any system and indeed in a firm and both indicate waste. The latter is the most obvious consequence of law of entropy (see for example the pioneering work by Georgescu-Roegen (1966, 1971). Table 11 shows which entropy-related PROBB variables are strongly correlated with these two V*s.

Table 11 High correlations between the waste and PROBB variables

⁵ In many economics applications a modern version of Boltzmann's formula is used: where S stands for entropy and f_i stands for the fraction in microstate i (see Ayres, 1994, p. 36).

| | | | | | | | | | | | | | | | |
|-------------|-------|-------|-------|------|-------|-------|-------|-------|-------|-------|-------|------|-------|-------|-------|
| V*16 | X5 | X25 | Y33 | Y39 | Y40 | Z2 | Z17 | Z27 | Z38 | W3 | W5 | W7 | W14 | W29 | W31 |
| corr | -0.16 | -0.15 | 0.2 | 0.14 | 0.23 | -0.15 | 0.14 | 0.22 | -0.19 | 0.16 | 0.16 | 0.17 | -0.23 | -0.18 | 0.21 |
| V*20 | X5 | X6 | X10 | X13 | X24 | X25 | Y33 | Y36 | Z24 | Z25 | Z30 | W2 | W13 | W24 | W30 |
| corr | 0.24 | 0.23 | -0.24 | 0.24 | -0.32 | 0.33 | -0.27 | -0.21 | 0.23 | -0.29 | -0.23 | 0.29 | 0.27 | 0.22 | -0.23 |

All signs of the correlation coefficients are the correct ones based on a priori considerations. For example, negative emotions (V*20) are negatively correlated with inertia (X10); this makes sense as a state of inertia (not enough actions) usually brings negative feelings, etc. These results will be further examined in the next section.

Discussion of main results and conclusion

Entropy is a well known phenomenon in physics. Social sciences have imitated its usefulness in the areas of economics, information theory, and so on, but without any substantial success. In the present study we consider entropy as a general natural tendency for waste and inefficiencies in business unless some measures are continually taken to slow down this tendency. This paper is only a modest attempt to quantify -in simple ways- the phenomenon of entropy in business. The latter takes various forms as seen in Table 1: waste, inertia, lack of information, and so on. In order to measure all these forms we used primary data of a survey of marine industry firms in Australia according to the PROBB (process of the ‘black box’) model. This model is represented by 109 organizational cum managerial variables shown in Table 2 of the text. The PROBB variables can *fully* describe and explain the structure and functioning of a firm. The main task was to measure the extent to which these PROBB variables affect some strategic cum performance variables (the Vs in the text). In general, when the PROBB variables are positively and strongly correlated with the Vs then we suggest that they become entropy-decreasing⁶ factors (and vice-versa).

Thus, “wasting time” (V*16) in firms is positively (see Table 10) correlated (therefore reinforcing each other) with “social relationships” (Y33), “imitating other firms” (Y39)“, “accumulating knowledge” (Y40), “measures to reduce work time” (Z17), “reliance on physical efforts” (Z27), “contracts with customers” (W3), “making rigorous contracts” (W5), “traditions and institutions” (W7), and “negotiations with management” (W31). On the other hand, V*16 is negatively correlated (hence time-reducing) with “use of formal objectives” (X5), “use of formal forecasts” (X25), “resolving problems as teams” (Z2), “performance according to customers” (Z38), “appreciation of governance” (W14), and “unselfish staff members” (W29). It would be worth examining each one of these relationships in more depth but this is out of the scope of this paper. Nonetheless the interested readers can still do that at their own discretion and time.

However, we must cross-check these results with the correlations between the above variables (in Table 11) and the strategic/performance variables Vs. Thus, “making rigorous contracts” (W5) is strongly and positively correlated (0.28) with “sales” (V21). Consequently, if we calculate the partial correlation between “sales” and W5 by controlling for V*16 we get 0.30, which is higher as expected than 0.28 because we took away the negative influence of V*16. Similarly for other cases we can get the net (partial) correlations but in general the differences between direct and partial correlations are not large.

For the “negative emotions” V*20 waste variable we have the following positive correlations with the PROBB ones: “use of formal objectives”⁷ (X5), “use of formal policies” (X6), “initiatives with

⁶ In other words these entropy-decreasing variables slow down the natural tendency for the firm to be disordered, or in every day language to be badly managed.

⁷ Note that the use of formal objectives (X5) enhances negative emotions (probably due to increased pressure to meet these objectives) whereas the same use of objectives decreases wasted time (negative correlation with V*16).

far reaching consequences" (X13), , "use of formal forecasts" (X25), "feedback mechanisms" (Z24), "contracts with suppliers" (W2), "firm form" (W13), and "international standards" (W24). Thus, contracts with suppliers (W2) usually have the tendency to "give headaches". On the other hand, "negative emotions" are enhanced by the following PROBB variables: "inertia" (X10), "improvisations when deciding" (X24), "social relationships" (Y33), "self-interest oriented staff" (Y36), "non-routine operations" (Z25), "automatic cooperation" (Z30), and "performance incentives" (W30). Thus, social relationships have the tendency to diminish negative emotions.

From Table 10 we can pinpoint more precisely the PROBB variables that contribute the least (not significantly related to any of the Vs) to the entropy problem. Thus, "inertia" (X10), "ad hoc decisions" (X18), "operations research methods" (Z15), "using transportation" (Z20), "tasks involving movements" (Z22), "transfers of people and equipment" (Z26), "fatigue problems" (Z29), "layout problems" (Z32), "functions" (W15), "status" (W16), and "resolving conflict" (W32) do not assist at all in reducing entropy in a given firm. On the other hand those PROBB variables that contribute the most (significantly related to at least six of the Vs) to the entropy problem (in improving it) are: "initiatives far reaching" (X13), "thinking capacity" (Y15), "imitation by other firms" (Y44), "international standards" (W24), "defending in markets" (X9), "rational decisions" (X15), "aggressive decisions re staff" (X21), "taking risks" (X27), "non-routine valuable operations" (Z25), "teamwork satisfaction" (Z31), "supervision rules documented" (W8), and "control measures" (W25). Many of these variables, both most entropy decreasing and least entropy decreasing are also present in Table 4 of the text which shows the impact of PROBB variables on the totality of the V variables. Thus, X10, Z22, Z29, and others are the least entropy decreasing variables that affect the totality of the performance variables V. These common⁸ PROBB variables in Tables 4 and 10 increase the confidence we have on the whole analysis.

Other important conclusions can be drawn from Table 9 of the text which shows the importance of each PROBB on the V variables in terms of entropy. Thus, the POS (process of strategies, see Table 2) is very important in determining -hence entropy-decreasing- V4 (13 POS variables out of a total of 27 are significantly correlated with V4). This means that the way firms decide and form strategies (POS) have a significant impact on the power firms have in dictating prices and/or quantities (V4). POS has also a significant entropy effect on V11 (adoption of technical innovations) and sales (V21). The process of wisdom (POW) is very prominent in determining product uniqueness (V9); this makes sense as firms need wisdom and knowledge to create a unique product. The other two processes (POM and POC) do not seem to influence a particular V variable more prominently.

Some general conclusions can also be drawn from the present study. First, it has become apparent that the PROBB model is consistent within itself, as all correlations examined in the context of entropy make sense. Second, although we have given more emphasis to the Vs in relation the PROBB variables, another way to determine the entropy impact on firms would have been to examine the impact of PROBB variables on themselves. This alternative is the object of another paper (where for example we could use structural equations models). Third, overall, we are confident that the present analysis has provided some evidence -in a simple way- about the impact of entropy-related variables on the performance and survival of firms.

⁸ It is expected that not all PROBB variables are present in both Tables 4 and 10 because the impact of these variables are either on the totality of Vs (hence Table 4) or on each V separately (Table 9).

Appendix 1: Definition of PROBB variables as per PROBB questionnaire

| POS (Process of Strategies) | POW (Process of Wisdom) | POM (Process of Movements) | POC (Process of Contracts) |
|-------------------------------------|---------------------------------|-------------------------------------|-----------------------------------|
| X1: use of formal strategies | Y7: using quant/e techniques | Z1: using teamwork | W1: contracts with employee |
| X2: use of formal planning | Y8: experience knowledge | Z2: resolve problems as team | W2: contracts with suppliers |
| X3: use of formal vision | Y13: education/ training | Z15: using operations research | W3: contracts with customers |
| X4: use of formal mission | Y14: information/ data | Z16: rationalize work | W4: support community |
| X5: use of formal objectives | Y15: thinking capacity | Z17: reduce work time | W5: rigorous contracts/documents |
| X6: use of formal policies | Y17: marketing intelligence | Z18: link work stages | W6: rigorous accounting rules |
| X7: expectations reflecting markets | Y18: transmitted knowledge | Z19: production routines | W7: traditions & institutions |
| X8: aggression in markets | Y19: product design | Z20: using transportation | W8: supervision rules documented |
| X9: defending in markets | Y20: insightful staff | Z21: movements organ/on | W9: ownership rules assistance |
| X10: Inertia state | Y21: culture in relationships | Z22: movements tasks | W10: informal v formal rules |
| X11: momentum | Y22: rational thinking | Z23: logistics | W11: conventional behaviour |
| X12: cautious style management | Y23: attitudes/beliefs of staff | Z24: feedback mechanisms | W12: rules of communication |
| X13: initiatives far reaching | Y31: socio-psycho/al values | Z25: non-routine operations | W13: firm form affecting you |
| X14: reaction unexpected | Y32: intuition/perceptions | Z26: transfers people and equipment | W14: governance appreciation |
| X15: rational decisions | Y33: social relationships | Z27: physical efforts reliance | W15: functions |
| X16: driven outside square | Y34: imagination constructive | Z28: physical efforts monitoring | W16: status hindering |
| X17: decisions market share | Y35: emotional state | Z29: fatigue problems | W17: hierarchy structure |
| X18: ad hoc decisions extent | Y36: self-interest of staff | Z30: automatic cooperation | W22: firm structure assisting |
| X19: Readiness to adversity | Y38: distinct capabilities | Z31: teamwork satisfaction | W23: standard legal documents |
| X20: easy decisions extent | Y39: imitating other firms | Z32: layout problems | W24: international standards |
| X21: aggression re staff | Y40: accumulated knowledge | Z33: ergonomics | W25: control measures |
| X22: asses/t before decisions | Y41: leadership vision | Z34: location of activities | W26: autonomy employees |
| X23: interpreting surroundings | Y42: leadership motivation | Z35: harmonized activities | W27: trust your employees |
| X24: improvisations deciding | Y43: unique culture | Z36: implementation prod/n | W28: attitude re authority |
| X25: use of formal forecasts | Y44: other firms imitating you | Z37: execution as expected | W29: selfish staff members |
| X26: uncertainty facing | Y50: needs in markets | Z38: performance as per customs | W30: performance incentives |
| X27: taking risks | Y51: outdated knowledge | | W31: negotiating with man/t |
| | | | W32: resolving conflict |
| | | | W33: equity if crucial |
| | | | |
| Total : 27 | Total: 27 | Total: 26 | Total: 29 |

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VERTICAL DEMAND-SUPPLY BUSINESS NETS IN TOURISM: SOME EMPIRICAL FINDINGS

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Abstract

This paper presents a case study of one vertical demand-supply business net, which operates in the field of tourism business. Theoretical framework for analysis is drawn from Actors-Resources-Activities-model and classification of business nets. The case business net is described in terms of actors, internal activities and information transfer activities between actors. The objective of this analysis is to reveal the connected actors and activities in order to develop management mechanisms and supporting ICT systems to be applied in the business net environment. Generally, the supply-side and business network research in tourism is a less researched area. Further research stemming from this case study includes the refined definition of actors, resource identification and more detailed analysis of the inter-actor relationships in terms of resource ties, actor bonds and activity links.

Keywords: *Business nets, business networks, tourism industry, business network analysis*

Introduction

In recent years there has been a strong development of different web-based e-commerce and e-business solutions in multitude of industries. However, the development has not been so strong in case of SME-driven tourism industry. In Finland, the adoption of e-business solutions has also been slow, even in the major tourism regions like Lapland. There have been several failures in the production of appropriate software solutions for tourism industry, the supply of information systems is low and tourism companies are sceptical of IT benefits in their business.

From this point of departure, there was a research project (ONI, Operative Network Integration), which aimed to model the tourism business operations conducted by interconnected group of companies. This group can be characterized as a vertical demand-supply business net. This model forms the basis for the design of potential information systems to be used in the SME-driven tourism industry.

In initial phase, the research questions were: What are the elements of vertical demand-supply business nets operating in the tourism industry? How are these elements connected to each other? What kind of information is transferred between them? These questions represent preliminary business analysis the process of information systems design.

To answer these questions, a theoretical framework was developed based on business network literature. Recent literature of tourism specific networks was reviewed and the theoretical framework was chosen from The Industrial Network Approach. A qualitative case study of one current business net was conducted. In this paper the theoretical background, research process and research results are presented and discussed. Also, some future research directions are brought forward.

Literature review

In general, the supply-side research of tourism is less advanced than the demand-side. This is attributed to the inadequacies of mainstream economic theories based on standardized commodities. Tourism products and the production processes are heterogeneous and complex. They are based on different kinds of technological know-how, e.g. retailing, tour operations, transport and hospitality. Tourism system should depict firms as functionally and technologically diversified, but interdependent in their aim to satisfy consumer needs. The network approach is suitable for analyzing tourism supply-side, maybe even so that term “tourism network” should be used instead of “tourism industry”. (Tremblay 1998) Li & Petrick (2007) suggest that tourism marketing is facing a paradigm shift to relationship marketing, network approach and service-dominant logic.

Gibson et al. (2005) examine local destination networks drawing from the business network lifecycle model (Morrison et al. 2002) and benefits of networks for tourism destinations (Lynch et al. 2000). The life cycle stages of the network are start-up, growth and reinvention and the benefits derived from the networks are related to learning and exchange, business activity and community. Novelli et al. (2005) have studied the role of networks and clusters in tourism innovations. Networks are able to provide firms access to knowledge, resources, markets or technologies. The success of tourism networks is related to network objectives, structure and leadership, resourcing, member engagement and inter-organisational learning (Morrison et al. 2004).

In their study of hospitality service networks, Kandampully & Promsivapallop (2005) describe how businesses are shifting from “generalists” to “specialists” and consequently are looking for complementary competencies from their network environment. This focus on the core competencies is the driving force behind strategic business networking. In her study of tourism policy networks, Dredge (2006) presents different dimensions of the networks: actors, functions, structure, institutionalisation, rules, power relations and actor strategies. These dimensions should be taken into account regarding the management of tourism networks.

According to Tremblay (1998), one of the network types in tourism is the “vertical alliance for tourists from location X”. This network connects different competences into a consistent product, requiring time and place synchronization of activities. Sorensen (2004) recognized the tourism production networks consisting of producers and users of different services. Production networks are not centrally coordinated with hierarchical organization or only by market-driven price mechanisms. The coordination exists in interaction between network actors. This network relies on information creation, gathering, application and communications. Information connects different producers of tourism experience. In production networks this information is operative (related to products, bookings, etc.) in nature, guiding the day-to-day operations.

The operation of the supply chain is central in the tourism industry. The products sold are intangible and perishable. The traditional supply chain includes suppliers, consumers, tourist boards, tour operators, travel agents and reservation systems. In other words, the product is a combination of accommodation, transportation, attractions, and a packaging service that binds these components together and sells them directly or through an intermediary to the consumer. (Gratzer 2003) Tourist destination is perceived as a system with inputs and outputs, containing components of attractions, services, infrastructure, and so on. Destination systems are under-researched from the producer’s perspective. (Tinsley & Lynch 2001)

Shih (2006) has used network analysis to investigate characteristics of drive tourism destinations and to plan appropriate facilities and services for each destination. Pavlovich (2003) has described the evolution and transformation of tourism destination network. Scott et al. (2008) use Network Analysis to examine structural properties of inter-organizational networks within tourism destinations. The information flows between key actors is basis for their analysis. Tourism involves more collaboration, partnerships and networks than most other economic sectors. In analysis of destination organizations, there are three basic elements: 1) actors, 2) relationships and 3) resources. Network analysis may reveal the weaknesses in destination structures. Stokes (2006) examines strategy formation in events tourism networks with three perspectives: 1) relationships, 2) actors and their positions and 3) structures and processes.

The Industrial Network approach is part of the marketing science and it has been developed by Industrial Marketing and Purchasing Group (IMP). Networks consist of firms and relationships between them. Through these long-term relationships resources are transferred from one party to another in economic exchange. Firms produce or use complementary or competing products/services in the network. (Ford 1990; Easton 1992, Håkansson 1989) This approach has been applied also in tourism related network research, e.g. Komppula (2000), Lemmetyinen (2002), Sorensen (2004), Saxena (2005), Scott et al (2008) and Stokes (2006).

Theoretical background

The model of Industrial Networks contains the following elements: 1) actors, 2) resources, 3) activities and 4) relationships. All the elements together form the network (see figure 1). Actors perform activities and control resources. Activities use resources to transform or transfer other resources (Håkansson & Johanson 1992). The substance of relationship between two actors consists of actor bonds, activity links and resource ties, in a network there are several relationships like this (Håkansson & Snehota 1995).

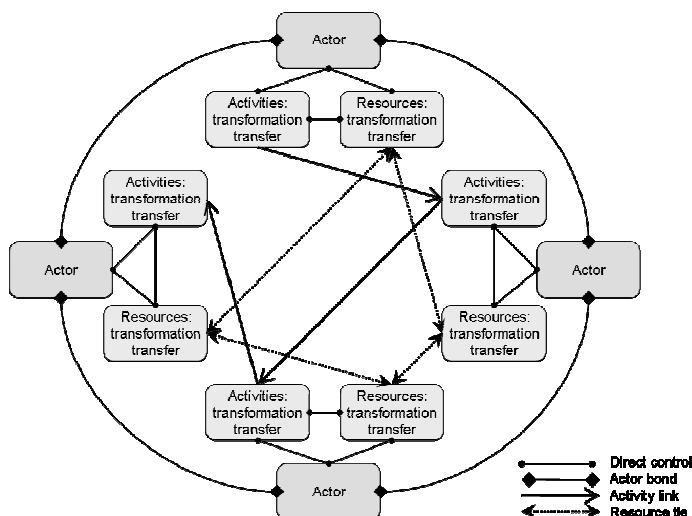


Figure 1. Business network elements.
(modified from Håkansson & Johanson 1992; Håkansson & Snehota 1995)

The actors can be individuals, groups, departments, enterprises or groups of enterprises. Regardless of the organizational level, they are able to determine what activities are performed, how they are performed and what resources are to be used. Actors have exchange relationships with each other and thus access to each others resources. The control of the resources is a key issue; there is a direct ownership over them or indirect access to them through relationships – leading to interdependencies between actors. The activities performed in the network are transformations or transfers in general nature. In transformations a resource is changed in some way by an actor. During transfer the direct control of a resource is shifted from one actor to another. Transfers link the transformation activities of different actors. These activities form cycles and ultimately the logical exchange chain. The resources are used in transformations and transfers. The availability of resources is a key issue: there is a competition for scarce resources and actors try to gain direct control over them. (Håkansson & Johanson 1992)

Actors in networks have relationships of interaction and interdependency. With relationships the actors are able to produce results that they cannot produce by themselves. In a relationship there are connections between actors in following levels: 1) activity links, 2) resource ties and 3) actor bonds. Technological, administrative, commercial and other functions of different actors and connected by activity links. Resources of technological, material or informational nature of different actors are connected by resource ties. The actors themselves are connected by bonds, which affect the way they perceive self and others in network. (Håkansson & Snehota 1995)

Business networks have three layers of structure and content: 1) production layer, 2) resource layer and 3) social layer. These layers are embedded and affect each other in complex ways. Production layer consists of firm actors that perform interconnected production activities. This layer is strongly characterized by the production value chain. Resource layer contains actors that offer resources for firm actors to perform production activities. Human actors (groups and individuals) and their relationships form the social layer of business network. (Holmlund & Törnroos 1997)

It is important to distinct the concepts of business networks and business nets. Business network can be seen as macro-level phenomenon, “industries-as-networks”. At this level the network might be limitless fabric of actors and relationships. Business networks consist of many smaller business nets. These are created consciously for some defined purpose by group of enterprises and/or other organizations. The network has its goals, but also the members of it have their own goals. Members have agreed about the roles and responsibilities for network activities. (Möller et al. 2006)

Möller et al (2006) classify business nets into three categories based on how radical changes of business environment they are aimed to achieve. The first category is the current (basic) business nets, which operate on developed industries with fairly stable value systems. The focus is on the internal and external efficiency of activities, requiring strong coordination, modularized and codified products and components. There is a potential to utilize information systems within the business net. The strategy may be to build efficient demand-driven value nets or to significantly reorganize the value creation system.

Current business nets operating within stable, well-defined value systems can be categorized as vertical demand-supply nets or horizontal market nets. Vertical networks draw on the specialized resources and competencies of producers in the value chain and aim for

increased efficiency. (Möller & Rajala 2007) Current business nets have to strategic perspectives: 1) demand-driven value network creation and efficiency and 2) significant reorganization of value creation systems. The former one is more common. Advanced product and component specialization creates need for integration services in business nets. Current nets aim for internal and external efficiency and effectiveness. Coordination of net can be managed with information systems, which improve demand-based production, capacity management, response times and transactions cost levels. (Möller et al. 2006)

Research method and process

Case study is a suitable method for business network research. One network can be studied intensively and form a holistic picture of that network by using several sources and informants. Instead of generalization, the goal is more in the comprehensive understanding of the phenomenon. Qualitative case studies enable examination of phenomena that are difficult to detach from their context. (Easton 1992; Halinen & Törnroos 2005; Sorensen 2004)

However, there are several challenges in using case studies in the research of business networks. The problem of network boundaries relates to separating content and context of a business network. The problem of complexity refers to business network structure of multiple actors and links, which makes describing the network not a simple task. The problem of time induces from the dynamic and changing nature of networks and it requires incorporation the dimension of time into research. The problem of case comparisons is related to problems mentioned before, a multiple case study of networks is extremely laborious and comparisons are difficult to make because of high context specificity. This reduces explanatory power and generalizability of network case studies. (Halinen & Törnroos 2005)

The network boundaries can be defined by the research problem, which guides the selection of important elements of network to be studied. Network boundaries can also be defined by actor perceptions of network structure and relevant actors, relationships, activities and resources. Network studies can be carried out by using focal organizations. Relevant close network of a focal company is a clear, although limited, point of departure for business network research. The complexity of network requires rich textual and visual methods of describing the cases and the researchers and network actors should be direct and close interaction with each other. The dynamics and temporality of a network can be captured by describing the network as processes. In order to compare cases, there should be a tight theoretical framework a priori. The informants should be as similar as possible in different networks. (Halinen & Törnroos 2005)

In this research, the target was to study a group of small businesses operating in the tourism industry. The focal company of this group was an incoming tour operator, which acquires different tourism-related services from different producers and packages the services for distribution to foreign markets via tour operators and travel agencies. Incoming tour operator also handles the tourist groups on-site during their trip on behalf of the foreign tour operator. Network is delimited to focal company and relevant partners, which have exchange relationship and participate in production of tourism service components. Network is operating in one destination and there are several other competing networks at the same destination.

The case can be described as a current business net that seeks to improve internal efficiency by enabling coordination and flow of demand-supply information between actors

with a suitable information system. The focus is on the core production network and the vertical distribution structure. Business net is studied through its actors on the production layer and resource layer, leaving out the human actors and social relationships. The core is described as activities and activity links. The actors are dependent of each other in the service process. Key element is also the inter-actor information flows of operative nature, not the explorative product development. Business net and its actor operate by seasonal cycle of regional tourism industry.

The case data was gathered over one year's time, the main source was the focal company and its informants. This was a rich information source due to its role in the business net. Data was also gathered from relevant partners and their informants. Most companies in business net are small or micro enterprises, except the larger hotel/accommodation companies. Informants were in role of owner/manager, sales manager or office manager. The informants were interviewed about company activities and links with other companies and their activities. From interview notes researchers formed the activity matrices combining company activities and internal/external information flows (see Närvänen et al. 2001).

Research results

The key actors in vertical demand-supply business net operating in tourism industry can be characterized as incoming tour operator, accommodation services, programme/activity services and transportation services (table 1, figure 2). All these actors produce a tourism service that is offered to customers, which can be individual end customers (tourists) or distributors (outbound tour operators or travel agents). All the actors have their own primary suppliers. Business net customers and primary suppliers are not analyzed in detail in this case.

Table 1. Tourism business net actors (modified from Saloheimo 2007)

| Actor | Description |
|-----------------------------|--|
| Incoming Tour Operator | Combining different tourism-related services to a sellable tourism product and distribution of the product to other intermediaries or directly to end consumer |
| Accommodation services | Service provision for tourist temporary stay in destination |
| Programme/activity services | Service provision for tourist experience (nature, culture, entertainment) |
| Transportation services | Service provision for transporting tourist groups between accommodations and programmes/activities |

Essential activities that actors perform entail the supply planning, order processing, resource management and preparations, service realization and feedback/maintenance (figure 2). Incoming tour operator triggers many activities by channelling demand to other business net actors. The activities are information intensive and information flows are very dynamic, there are many resource allocations, confirmations, cancellations, rules and conditions etc. During high season when large volumes of tourists are travelling, the management and inter-actor coordination of information flows and activities becomes very laborious.

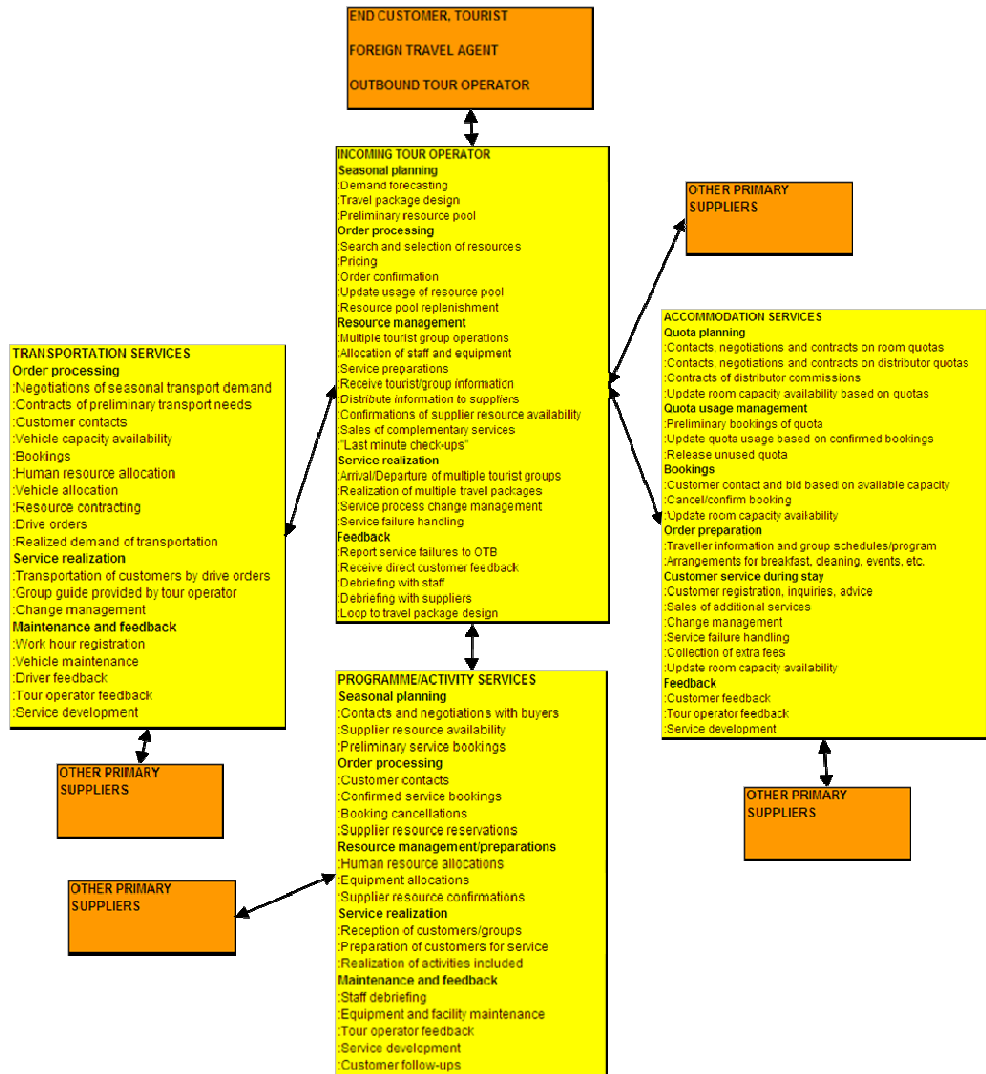


Figure 2. Key actors and activities in tourism business net.

In this case, the relationships between actors are viewed as activity links. These links are analyzed as information transfer between actors and their activities (figure 3).

| | | | | | |
|--|--|---|--|---|--|
| END CUSTOMER, TOURIST | Travel package development ideas Travel package acceptance Demand estimates Realized demand | | | | |
| FOREIGN TRAVEL AGENT | Travel package acceptance Demand estimates Realized demand | | | | |
| OUTBOUND TOUR OPERATOR | Travel package requests Travel package purchases Travel and group information Cancellations and changes Feedback reports | | | | |
| Travel package development ideas Travel package suggestions Travel package descriptions Travel package formation Travel package sales Confirmations Cancellations and changes Service failure notifications Feedback reports | INCOMING TOUR OPERATOR Seasonal planning Order processing Resource management Service realization Feedback | Quota demand Quota reservation Quota release Room availability Room bookings Travel and group information Cancellations and changes Feedback | Service development ideas Service demand estimates Service demand realization Service requests Service purchases Group information Cancellations and changes Feedback | Service demand estimates Service demand realization Service requests Service purchases Group information Cancellations and changes Feedback | Requests and purchases for human resources Requests and purchases for equipment Requests and purchase for other supplies |
| Quota supply Quota usage Availability notifications Booking confirmations Cancellations and changes Travel and group information Feedback | ACCOMMODATION SERVICES Quota planning Quota usage management Bookings Order preparation Customer service during stay Feedback | | PROGRAMME AND ACTIVITY SERVICES Seasonal planning Order processing Resource management Service preparations Service realization Maintenance and feedback | | Requests and purchases for human resources Requests and purchases for equipment Requests and purchase for other supplies |
| Service development ideas Service supply Service sales Confirmations Service failure notifications | | | | TRANSPORTATION SERVICES Order processing Service realization Maintenance and feedback | Requests and purchases for human resources Requests and purchases for equipment Requests and purchase for other supplies |
| Service development ideas Service supply Service sales Confirmations Service failure notifications | | | | | |
| Contracting of human resources Contracting of equipment Sales of other supplies | Contracting of human resources Contracting of equipment Sales of other supplies | Contracting of human resources Contracting of equipment Sales of other supplies | Contracting of human resources Contracting of equipment Sales of other supplies | Contracting of human resources Contracting of equipment Sales of other supplies | OTHER PRIMARY SUPPLIERS |

Figure 3. Information transfer between actors and activities.

In the matrix, the information flows are marked in following manner:

| | | | |
|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Customers | Information from customer to Actor A | Information from customer to Actor B | |
| Information from Actor A to customer | Actor A Activities | Information from Actor A to Actor B | Information from Actor A to supplier |
| Information from Actor B to customer | Information from Actor B to Actor A | Actor B Activities | |
| | Information from supplier to Actor A | | Suppliers |

Figure 4. Diagonal matrix of activities and information.

The information transfer activities entail the demand forecasts, preliminary resource allocations, realized demand (orders, bookings), resource management, change management during service preparation/realization and service feedback (service failures, service development). The incoming tour operator is the nexus for information transfer and distribution.

It is notable, that an incoming tour operator has many producers of accommodation, programmes and transport. Likewise, these producers are offering their services to other operators also. In business net depiction, the multitude of firms has been aggregated to actor roles. The firms are competing of resources (room capacity, bus capacity, market access, etc.) in this destination business environment. The configuration of tourism business nets in general may vary considerably in terms of different intermediaries (see e.g. Gratzner 2003). Tourism industry in Lapland is relying on tour operators and the portion of direct consumer sales is considerably smaller.

When the vertical demand-supply business net was analyzed by Enabler-Effect-Map method, several potential benefits of information systems were derived (see more details in Soukka & Saloheimo 2007). These benefits include significant reduction of manual information input and processing, reduction of administrative tasks, improved control information of business, enabling analysis, planning and efficient use of resources in service execution. Information system should be provided by specialized actor in business net, application service provider.

Conclusions

The recent literature of tourism networks research contain many descriptions of networks seem from the theoretical viewpoints of social networks and graph theory. Often these descriptions are structural, revealing the nodes and connections in the network. In order to develop information systems and management tools for tourism business, the networks should be described in a more detailed manner. The model presented in this paper aims to answer this need. The results are context-specific and therefore difficult to generalize or transferred to different context. There is a need for comparable and similar case studies in tourism business to refine and confirm this model.

The essential empirical findings of this study is identification of key actors in vertical tourism demand-supply net, namely the

- Customers (tour operators, travel agents, tourists)
- Incoming tour operators
- Accommodation service producers
- Programme and activity service producers
- Transportation service producers
- Primary suppliers

The other essential finding is the business net activities of:

- Seasonal planning
- Order processing
- Resource management
- Service preparation
- Service realization
- Feedback and maintenance

Third, the information transfer between business net actors is concerning the:

- Service development
- Demand forecasts
- Available resources
- Realized demand
- Resource allocations
- Service process change management, failure resolution
- Feedback

The main contribution of this case study is the documentation of key actors, activities and relationships of information exchange in one tourism industry vertical demand-supply business net. Similar analysis and appliance of Actors-Resources-Activities model is not found in tourism research literature. Future extension of this research should include the analysis of business net resources and actor dependencies of these. Also, the relationships of actors should be analyzed in more depth (e.g. the contractual and social perspective). In addition to information systems, a framework for network management should be developed.

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THE IMPORTANCE OF FOREIGN DIRECT INVESTMENTS ON ECONOMIC DEVELOPMENT OF KOSOVA

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Abstract

Kosova, in the period of nine years, has gone from a post-conflict environment into a state which is considered to be under transition. It has passed the reconstruction period by orienting itself toward the economic development and European Integrations. Yet, an economic development is not enough to be able to address the challenges Kosova is facing, such as high unemployment and high trade deficit rate. The unemployment rate in Kosova is one the highest economic concerns. The unemployment rates fluctuate from around 30% (FMN 2004) up to 40% (ESK, 2006). The high deficit of the current account of balance of payments is also a concern for the Kosova's economy; which is estimated up to 17.3% of the GDP after the foreign intervention. The high deficit of current account is being considered one of the highest ones in the region, whereas the main source of this deficit remains the high level of imports. Therefore, in order to overcome such problems, higher levels of investments are needed. Countries that invest higher proportion of their GDP tend to grow faster. However, as lack of the domestic capital and financial investments, i.e. Kosova, foreign investments represent the most effective way to create new jobs and to create the preconditions for a sustainable economic growth in the future. The aim of this paper is to offer information about the overall investment path including the foreign ones in Kosova in the war aftermath, as well as to analyze the opportunities and priorities for possible future investments.

Keywords: *Foreign direct investment, economic development, unemployment, imports, trade deficit.*

Introduction

Physical capital has always stood at the core of economic progress explanations. Countries that invest a large portion of GDP tend to develop faster. In order to invest, a country needs to make savings or have access to foreign savings or assistance. Except for the private sector, the government also has an impact on the level of national savings, and it conducts this through its budgetary policies. After utilizing its internal economy, countries may attract foreign savings in order to finance investments. A country under development may draw foreign investments in the following three ways. One possibility is to have foreign companies invest directly in the country. The second method, through which a country may draw foreign resources, is by means of credits obtained at the global capital market or through financial institutions such as the World Bank. Thirdly, a country may be able to obtain foreign assistance from industrialized countries. However, the lower the income per capita in a country, the more important are foreign savings, such as in the case of Kosovo.

Foreign Direct Investments (FDI) represent the flow of international organisations in various countries, to which on the latter decades a great deal of attention is given, since their number has increased in an extraordinary manner. Based on the OECD and IMF data, the total value of FDI at the global level has increased from \$105 billion, in 1967, to 596 billion dollars in 1984. Only in the USA during the period of 1960-1985, FDI increased from 6.9 to 183 billion dollars.¹

¹ Ilia Kristo, International Business, Tirana, 2002, page 264

Bearing in mind the fact that Kosovo currently faces problems with impediments of various natures, which impede its economical development, FDI could play a key role in the economical development of Kosovo. Kosovo faces lack of financial resources for financing investments, while there is constant pressure for resolving the unemployment problem. Therefore, it is considered that FDI will play a positive role in the Kosovo economy, by introducing fresh capital, modern technology, western experience in the field of marketing and management. Simultaneously, they will assist the restructuring of the economy, opening up of new working places, increase of export and decrease of the trade balance deficit. Factors that characterize the current condition of the Kosovo economy and that make Kosovo a specific country that needs FDI is as follows:

- Significant decrease of foreign assistance in the form of donations after 2003,
- Kosovo banking system is still unable to provide adequate financing for business development (long-term loans, low interest rates, greater volume),
- Considerable decrease of remittances from Kosovo emigrants located in various countries of the world,
- Great needs for investment in the public infrastructure,
- Low rate of unemployment,
- Lack of financial markets.

General information on the Kosovo economy

Economic activities of Kosovo prior to the conflict in 1999 were focused in the industry, energy, mines and metalurgy, construction materials and processing of agricultural products. During the 90's, the Kosovo economy has marked a considerable decrease, initially due to a lack of required investments, secondly due to the devastation of production infrastructure and capacities devastated by the conflict of 1999. Therefore, Kosovo as a post-war country, as well as with a subsequent transition phase, compared to the countries of the region, has also faces a very low level of foreign investments.

In 1988, the general production of Kosovo was dominated by industry, which comprised about 50% of the GDP, whereas agriculture comprised only about 20% of GDP². Economic development during the 2000-2006 period was characterized by a small economic increase compared to the fairly low base at the commencement of the transition, as a generally unsustainable macroeconomic indicator, which may be observed from the table provided below.

Table 1 Some key macroeconomic indicators

| | Years | | | | |
|------------------------------------|-------|-------|-------|-------|-------|
| | 2002 | 2003 | 2004 | 2005 | 2006 |
| Real GDP growth (%) | 9.6 | 8.3 | 2.1 | 0.3 | 3.0 |
| Inflation (%) | 3.6 | 1.2 | -1.4 | -1.4 | 0.7 |
| Growth of investments | -9 | -7 | 25.1 | -26.0 | 29.4 |
| Increase of export (%) | 2.2 | 0.1 | -8.7 | -11.1 | 30.3 |
| Increase of import (%) | -5.6 | -4.5 | 1.0 | 9.4 | 13.3 |
| Coverage of import with export (%) | 2.3 | 2.4 | 7.7 | 6.5 | 8.1 |
| Remittances (mil. euro) | 341.4 | 341.4 | 215.0 | 281.0 | 318.0 |
| Foreign assistance (mil. euro) | 897.5 | 698.7 | 565.0 | 491.0 | 465.0 |

Source: IMF, Aide Memoire, February 2007

² UNDP, Human Development Report, Kosova, 2006, page 27

The immediate increase of the GDP until 2002 was fairly affected by the large amount of international donor contributions, which amounted to approximately 900 million Euros and was concentrated in the construction of houses and infrastructure damaged by the conflict of 1999. Afterward, this assistance had decreased considerably and by 2006 it is considered to be two times lower than in 2002. The adoption of Euro as a national currency has been in favour of sustainable monetary policies and exchange rates. The trade deficit remains high, whereas exports are scarce and due to limited production capacities for export and inability to cope with the competition. The coverage of import with export is still very low, at about 8%.

Even though it is clear that Kosovo needs a higher rate of economic growth in order to address the challenges it faces, the level of economic growth in 2006 should be considered encouraging, because it had been achieved not with standing the limiting effects that have resulted from the reduction of donor assistance (from 426 million Euro to 343 million Euro) as well as the reduction of government capital expenditures. This growth has been mainly supported by the private sector investments, which were financed by credits of the banking sector and FDI.

Due to the high consumption rates in relation to GDP, national savings in Kosovo are negative, achieving the mark of 15.3% of the GDP. At the end of 2006 investments in Kosovo amounted to 618 million Euros and were by 4.0% higher than those of 2005. From 2001, when investments were at their peak by amounting to 661 million Euros, a gradual decrease of investments was noted until 2003, whereas from 2004 a slight increase of investments followed. During 2005 about 22% were spent from the total budget on behalf of capital investments, which is about 1% lower than in 2004. On the table below you have the total investments in Kosovo from 2001 until 2006.

Table 2 Investments in Kosovo, 2001-2006, in millions of Euro

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|----------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Investments | 661 | 603 | 572 | 594 | 600 | 618 |
| Donor sector | 245 | 180 | 132 | 65 | 69 | 86 |
| General government | 6 | 15 | 36 | 169 | 153 | 153 |
| Private investments | 409 | 408 | 404 | 357 | 376 | 383 |
| Housing | 300 | 258 | 241 | 190 | 195 | 195 |
| Others | 109 | 150 | 163 | 167 | 181 | 188 |

Source: IMF staff estimates, 2006

Except for volume-based growth, investments also increased as part of GDP, at 28.3% in 2006, which is one of the highest in the region. However, the value of GDP in Kosovo, during the reviewed period, was lower; in 2006 it amounted to 2,477 million Euros, which is noticeable on the data presented on table 3. Only Croatia, with 31.3% had a larger participation of investments in GDP, within the framework of regional countries, whereas all the other countries had a lower participation, such as Bulgaria - 28.0%, Albania - 26.6%, Romania - 22.7%, Bosnia and Herzegovina - 20.3% etc.³

³ EBRD (2006), AQBK (2006)

Table 3 GDP in Kosovo during the period 2001-2006, in million Euros

| | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 |
|-----------------|-------|-------|-------|-------|-------|-------|
| Consumption | 2,680 | 2,623 | 2,600 | 2,711 | 2,660 | 2,667 |
| Investments | 661 | 603 | 572 | 594 | 600 | 618 |
| Net Export | -901 | -780 | -753 | -800 | -806 | -808 |
| GDP | 2,439 | 2,447 | 2,420 | 2,505 | 2,453 | 2,477 |
| Budget revenues | 307 | 498 | 492 | 635 | 609 | 655 |

Source: IMF, Aide Memoire, February 2007

Sources of investments in Kosovo are loans from the banking sector and FDI. On average, each year since 2002 the flow of loans of the banking sector ranged at about 140 million Euro in the local economy, in which case the vast majority was provided to the private companies. FDI in 2006 was assessed to be at 266.3 million Euros, compared to 59 million Euros in 2005.

Immediately after the war, in the emergency reconstruction period in Kosovo, there were investments by various donors. The vast majority of donor investments during the period of 1999-2004 were focused on public services (26%), housing investments (16%), economy, industry (13%), education and health (9%), transport and infrastructure (6%), police and justice services (5%)⁴ and so on.

During the same period (2001-2006) the Southeast Europe region had undergone an industrial reformation from considerable revenues of FDI, realized from an improved investment climate, achieved mainly from reforms undertaken for EU membership, which means economic stability measures in order to maintain a sound position of the monetary and fiscal system. The net FDI in the region has increased from \$13 billion in 2005, to \$19.3 billion in 2006, which indicates an increase of 48.5%. The highest level of FDI was marked in Romania, where FDI was at \$ 8.65 billion, in Serbia \$3.5 billion and in Bulgaria \$3 billion. The lowest level of FDI was marked in Montenegro with a net FDI of \$150.2 million, which is visible in Table 4.

Table 4 Net Foreign Direct Investments (million dollars)

| Years | Albania | B&H | Bulgaria | Croatia | FYROM | Montene gro | Rumania | Serbia |
|---------|---------|-------|----------|---------|-------|----------------|---------|---------|
| 2001 | 204.0 | 130.0 | 803.3 | 1,178.5 | 440.7 | 10.0 | 1,154.0 | 165.0 |
| 2002 | 135.0 | 266.0 | 876.3 | 585.6 | 77.7 | 84.0 | 1,080.0 | 475.0 |
| 2003 | 178.0 | 382.0 | 2,070.3 | 1,932.0 | 96.0 | 44.0 | 2,156.2 | 1,360.0 |
| 2004 | 332.2 | 490.0 | 2,777.1 | 870.9 | 155.9 | 63.3 | 6,368.0 | 966.0 |
| 2005 | 264.8 | 300.0 | 2,297.9 | 1,509.1 | 97.0 | 474.3 | 6,587.3 | 1,481.0 |
| 2006 | 350.0 | 570.0 | 3,000.0 | 2,824.8 | 300.0 | 150.2 | 8,652.0 | 3,500.0 |
| Average | 244.0 | 356.3 | 1,970.8 | 1,483.5 | 194.5 | 137.6 | 4,332.9 | 1,324.5 |

Source: Business Monitor International (2007); EBRD (2006)

⁴ MTI, Annual Report 2006, Prishtina, page 7

Foreign Direct Investments in Kosovo during the period of 2000-2006

Kosovo, as a post-war country, with large material and economic devastations, as well as with a succeeding transitional phase compared to the regional countries, has also faced a very low level of foreign investments. From 2000 until 2006, FDI in Kosovo reached the amount of 790 million of Euros, whereas the number of foreign registered businesses was 1,304. The table below provides the number of foreign enterprises that have invested in Kosovo.

Table 5 Number of foreign enterprises that have invested in Kosovo

| Type of enterprise | Quantity | % |
|--|-------------|------|
| Production, extraction and processing enterprise | 180 | 11.5 |
| Construction enterprise | 120 | 7.5 |
| Trade enterprise | 1002 | 63 |
| Service enterprise | 286 | 18 |
| Total | 1588 | |

Source: Annual report, Ministry of Trade and Industry, Prishtina, 2007, page 13

From the data provided in the table, we can observe that foreign investors in Kosovo have mostly invested in trade enterprises (63%), afterward in service enterprises (18%), production, extraction and processing enterprises, (11.5%) and in construction enterprises (7.5%). The Agency for the Promotion of Investments in Kosovo (APIK) has prepared a list of foreign enterprises which have invested large capital in Kosovo, listing them according to the sector in which they have conducted their investments:

1. Raiffeisen Bank from Austria, finance sector;
2. Procredit Bank from Germany, finance sector;
3. Nova Ljublanska Banka from Slovenia, finance sector;
4. Telekom Slovenia &IPKO NET from Slovenia, telecommunications sector;
5. Insurance Company "INSIG" from Albania, insurance sector;
6. Alferon from Great Britain, mine sector;
7. Llamkos from India, metallurgy processing sector;
8. Xella from Austria, construction material sector;
9. Kosovaplast from Macedonia, construction material sector;
10. Semenarna from Slovenia, agriculture sector;
11. Sharr Cem from Switzerland, cement production sector;
12. Silosi from Switzerland from Macedonia, food industry sector;
13. Winery Rahovec from USA, winery sector;
14. Newco Trofta Istog from Belgium, hotel and food sector;
15. Scan colour from Norway, sector of paints.

The vast majority of foreign enterprises that are present in Kosovo have commenced their activities following the conclusion of the conflict of 1999. Most of them come from neighbouring Balkan countries such as: Albania, Macedonia, Serbia, Montenegro, Bulgaria and Turkey. Moreover, a considerable number of enterprises come from the EU countries as well as the United States of America.

Although Kosovo is a small market, its geographical position represents an important element for the presence of foreign enterprises in Kosovo with the aim of expanding in the market of the regional countries and furthermore.

The table below represents the countries as well as the number of enterprises that have invested in Kosovo:

Table 6 Number of foreign enterprises based on countries of origin

| No. | Country | Number of enterprises |
|--------------|----------------------|-----------------------|
| 1. | Austria | 21 |
| 2. | Belgium | 6 |
| 3. | Great Britain | 4 |
| 4. | Bosnia & Herzegovina | 9 |
| 5. | Bulgaria | 38 |
| 6. | Egypt | 9 |
| 7. | France | 10 |
| 8. | Greece | 12 |
| 9. | Germany | 87 |
| 10. | Italy | 35 |
| 11. | India | 56 |
| 12. | China | 233 |
| 13. | Croatia | 21 |
| 14. | Macedonia | 211 |
| 15. | Moldavia | 14 |
| 16. | Pakistan | 25 |
| 17. | Rumania | 2 |
| 18. | Slovenia | 39 |
| 19. | Serbia | 11 |
| 20. | Albania | 142 |
| 21. | USA | 29 |
| 22. | Turkey | 169 |
| 23. | Thailand | 6 |
| 24. | Switzerland | 36 |
| 25. | Others | 79 |
| Total | | 1304 |

Source: Official MTI data, 2006

Foreign investments in Kosovo based on regions and municipalities

Based on the data of the Ministry of Trade and Industry, it results that the greatest participation of business activities of foreign investors is in the Prishtina region, at 60%. We can hereby conclude that foreign investors are oriented in the locations in which economic development has had higher trends of development and better conditions, such as infrastructure, higher concentration of population, proximity to the airport, market etc.

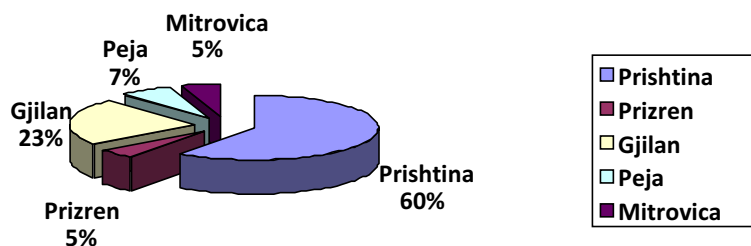
Five regions that include municipalities characterized by differing levels of investment attraction are as follows:

- Prishtina (Fushë Kosovë, Lipjan, Obiliq, Shtime, Podujeve, etc.)
- Gjilan (Ferizaj, Viti, Dardane etc.)
- Peje (Gjakove, Deqan, Kline, Burim etc.)
- Prizren (Therande, Rahovec, Dragash, etc.)
- Mitrovica (Vushtri, Skenderaj etc.)

The regional structure of investments conducted by foreign enterprises in Kosovo is illustrated by the following graphical data:

Graph 1

Structure of enterprises based on regions



Source: Ministry of Trade and Industry, Bulletin, Prishtina, 2006, page 4.

From the data presented it is evident that the region of Prishtina leads in the attraction of foreign investments, the second is the region of Gjilan, Peja, followed by Prizren and Mitrovica.

Conditions/possibilities of investment in Kosovo

Kosovo is located at the centre of the Balkan Peninsula, between Serbia, Macedonia, Montenegro and Albania. Kosovo is connected by the regional road Belgrade-Prishtina-Skopje through the valley of the Iber River, regional road Nis-Prishtina-Adriatic Sea and with railway connection Belgrade-Fushe Kosove-Skopje. Kosovo is connected to Albania through the Prishtina-Prizren-Kukes-Tirana road. Kosovo also has its own international Airport in Prishtina. Regional vehicle and rail roads join in Kosovo and enable a more efficient connection to the Adriatic Sea, Aegean Sea and Ionian Sea. Position and climate are important factors for the development of many economic activities. There are several factors that affect the promotion of investments in Kosovo, however, the following are considered more important:

- Natural and human resources
- Flexible working market and competitive working force
- Stimulating business environment
- Stable banking system
- New customs code – customs alleviations
- Low tax regime

Natural and human resources – Republic of Kosovo has an area of 10.887 km² and more than 2 million inhabitants (estimate of 1991)⁵, and an average density of 192 inhabitants per square kilometre, represents the areas with the highest density in the Balkan peninsula. The majority of the population, or 90% are Albanians, 8% are Serbs whereas 2% are of other nationalities: Turks, Muslims, Ashkalis, Romas, Egyptians etc. Kosovo is a country with the youngest population in Europe, in which 70% of the population is under the age of 35, which represents a young and motivated population for education and work, it is particularly characterized by an entrepreneurial spirit. The average salary is under 220 Euro. In Kosovo, the Albanian, Serbian and English languages are used as official languages, however, there is a

⁵ Ministry of Environment and Spatial Planning, Kosovo Institute for the Protection of Nature, Natural Heritage Values of Kosovo, 2005, Prishtina, page 23

large number, especially the youth, which are familiar with European languages, such as: German, English, Italian, Swedish, French etc. Kosovo provides a modern system of telecommunications as well as young educated generations with a satisfactory level of informatics knowledge as well as higher levels of internet communications technologies, moreover, a considerable number of youth which is educated in western universities. Whereas, on the other hand, there is great interest from these generations to emigrate in order to find jobs due to the insufficient capacities of the Kosovar economy to generate new working positions.

Table 7 Labour market characteristics of Kosovo

| Age | Male | Female | Total |
|-------|------|--------|-------|
| 16-24 | 39.1 | 41.4 | 40.2 |
| 25-34 | 30.4 | 30.6 | 30.5 |
| 35-44 | 18.1 | 19.5 | 18.8 |
| 45-55 | 8 | 6.7 | 7.4 |
| 55-64 | 4.4 | 1.8 | 3.2 |

Source: Riinvest Institute, Labour market and unemployment in Kosovo, 2003

From the table above it is evident that the youth comprises the largest portion of the labour market in Kosovo, from the age of 16 – 24 (40.2%). Whereas, about 20000-25000 people look for work in the labour market on an annual basis. It is estimated that about 500.000 inhabitants live and work temporarily in various western countries.

There are few countries or administrative-political territories that have such a diversity of resources of mineral raw materials and energy resources in such a small area as does Kosovo. Based on geological research, it has been concluded that Kosovo has significant primary energy, metal and non-metal resources. Kosovo has an immense quantity of coal and lignite; its reserves are estimated at 14 billion tons⁶. Research has concluded that there are significant reserves of minerals such as lead, zinc, (21.6 millions of tons), silver, gold, cadmium, bismuth, nickel (14 millions of tons), aluminium, chrome etc. Kosovo also has large reserves of mineral non-metallic resources, especially magnesium (about 4.5 millions of tons), kaolin, benton, asbestos etc. The potential of natural resources of Kosovo represents a good basis for its development in the future, however it is not being used to the extent required due to lack of investments. Due to its climate, good tradition that exists as well as diversity, from orchards, vegetables to wheat, this sector has been determined as one of the sectors of the highest priority. Kosovo is known for the production of wheat, cabbages, potatoes, fruits, wines, mushrooms, tobacco etc. However, the agriculture of Kosovo is characterized by small farms as well as low production capabilities.

Tourism also represents an underused potential for the economic development of Kosovo. The territory of Kosovo has a very complex natural composition with mountainous, field, river zones that are very attractive, beautiful views, natural and historical monuments. Some of the most representative values of Kosovo nature are as follows: Natural Park (Malet e Sharrit), Skiing Centre in Brezovica, Marble Cave in Gadime, Mirusha Canyon, Germia Park, Bifurcation of river Nerodime, Rugova valley etc.

Political Stability – The political situation in a country has a decisive impact on the attitude of foreign investors. Kosovo now as an independent country has established its institutions and has held free elections several times, both at the local and central level and it has proven that it

⁶ Aziz Abrashi, Burhan Kavaja, Natural Resources of Kosovo in the interest of economic-social development, UESH, 2000, Prishtina, 2000, page 356

is capable of conducting such elections in a democratic manner. Following the declaration and recognition of independence, the establishment and operation of government institutions is a key priority of the Kosovo Government. The main objective and destination of Kosovo is undoubtedly the European Union. Therefore, the Kosovo Government is dedicated to implement policies which ensure Kosovo permanent peace, stability, security and cooperation with regional and other countries. Security in the country has demonstrated positive trends in the aspect of the decrease of political crimes and crimes that put life and property in danger. KFOR, within the framework of NATO forces, guarantee security in Kosovo. Recognizing the fact that proper economic development and general economic welfare of Kosovo depends on the existence of a strong and competitive private sector; the Government of Kosovo is engaged in the establishment of a legal framework lead by a market-oriented economy and in favour of business. In order to contribute to this end, among other, the Law on Foreign Investments has been endorsed, which assist and encourages foreign investments in Kosovo through some basic and executable rights for foreign investors, and which also guarantees the foreign investors that their investments will be protected and treated in a fair manner and in accordance with the rule of law and acceptable international standards and practices. The law aims at enabling the complete integration of Kosovo in the regional, European and global economy by encouraging the flow of capital, modern technology, know-how, financial and intellectual services, and management and information capabilities in Kosovo.

Low tax regime – The tax system in Kosovo is a modern system that enables Kosovo to raise budgetary revenues at approximately 30% of GDP, making it possible for Kosovo to be at a comparable position to the regional countries. Kosovo for the time being has a relatively simple tax system, based on uniform and all-inclusive taxes. However, in the future there are needs for new reforms in the aspect of broadening the tax base and regulation of expenditures such as salaries, goods and services, subsidies and transfers, in order to increase capital expenditures and address the need for investments, necessary to successfully face the structural problems of the economy. With regards to taxes that are related to the business activity, the following tax level prevails:

- Customs tax on import of 10% and 0% tax for capital goods and agricultural inputs
- VAT – 15%
- 0% export tax
- Income tax: from 0 – 20%
- Corporate income tax 20%.

The Kosovo market is liberalized with regards to the foreign trade regime, however, this liberalisation forces local businesses to face fierce competition from the imports, which brings them difficulties, since it is not easy for them to tackle this. However, Kosovo is interested to sign bilateral trade agreements with other countries in order to ensure a higher level of trade exchange. Now, Kosovo has signed a Free Trade Agreement with Albania, Macedonia, Bosnia and Herzegovina, and Croatia and is a member of CEFTA (Central European Free Trade Agreement), a membership which ensure Kosovo exporters access free of customs obligations to the regional market composed of 25 million consumers⁷.

Financial Sector – represents one of the sectors with highest level of development in the local economy. In particular, the Banking sector of Kosovo, with 7 commercial Banks, marks positive trends and has a continuous increase of deposits and credits; however there is room for improvement. Kosovo Banks are among the best in the region, both in the level of development

⁷ Economic Initiative for Kosova: Top 10 reasons to invest in Kosova

and trustworthiness and they enjoy. However, there is an opinion that interest rates are relatively high (11-13%, depending on the type of credit) and not stimulating for investments. The sole method to have lower interest rates is through the increase of competition.

Conclusion

Based on the experiences of economical development of countries that have gone through the transition stage in the latter years, we could say that FDI plays a key and very significant role in the economic development of countries in transition, in particular of countries in development and concurrently have a multidimensional positive impact. Such investments are very necessary for the current period of development in which Kosovo finds itself, since it is facing a lack of own financial resources for investments. Therefore, foreign investments represent the most efficient method of achieving a positive impact, as they enable:

1. Sustainable development, much better than loans in the form of credits, due to the fact that foreign investments do not entail interest rates that put the investor at risk of being overloaded with debt,
2. Promotion of the development of human capital based on the transfer of new technology, knowledge and training,
3. Increase of budgetary revenues, as a result of the increase of taxes from the larger number of businesses and employees as well as the decrease of the need for subsidies,
4. Alleviated penetration into the regional, European, and other markets,
5. Increase of export and improvement of the trade balance (decrease of the trade deficit),
6. A positive connection has been ascertained between investments and GDP.

Therefore, the main objective of the competent bodies in Kosovo is to make foreign investments a significant resource for the economic development of the country. This objective may be achieved by conducting an active policy that would present Kosovo as the right and lucrative location for foreign investors.

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CONNECTIONS BETWEEN MONETARY POLICIES AND GLOBALIZATION

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Abstract

The last decades have been marked by an acceleration of historical and political processes, which brought essential changes in the sphere of geopolitics with ongoing consequences on economics, financial markets and international relationships, and effects on the arising of new worldwide power balance.

The economic relationships were set before the foundation of the first states. Commercial relationships have had a long history and at the beginning were independent of the social and state organizations existing at the time. That is why bilateralism – as applied with reference to the relationship between two economic agents - is the oldest notion since life necessities have always implied the exchange of products.

Despite these tendencies autarchy dominated economic life ever since this came into being until the great geographic discoveries and industrial revolution.

Economic “coagulations” have continued in the course of time and become more prominent reaching unimaginably impenetrable levels recently, thus constituting a balance factor at regional and international level. Present evolutions confirm the old provisions concerning the indissoluble relationship between the economic and the financial monetary factor and international stability.

Key words: *market integration; integration by investments and institutions; competitive policy; cooperation policy.*

Introduction

One of the most approached problems of the last decades has been the one of economic and financial monetary integration, implying the interests of states, classes and nations.

Etymologically the term *to integrate* means *to include* or *to comprise in a whole*.

The French economist Jean Weiller tries to enlarge the meaning of the definitions given to the concept of integration. For him “integration is not a simple act of adding, but, in a given space, it means increasing the possibilities of decision plan centre coordination, with a view to create a single economic system. The study of integration means rising above the level of the market and focusing on decision, anticipation and intentions.” This definition refers to western European integration and the “decision centres” are the authorities and the bodies of the different national states involved.

For economists like Viner, Seitovschi, Haberler integration simply means putting into contact the existing economies by eliminating all barriers that oppose change. This integration would be nothing else than the creation of a vast free market, formed by uniting two or more economies. In this case, according to André Marshall, one cannot speak about integration but about a juxtaposition of economies that each preserve their own characteristics and that become more or less independent of each other, each of them being affected by the consequences deriving from their neighbour influence. The true integration according to André Marshall is the one conceived in the structural and voluntary meaning of the word: “It

manages to combine the different elements that make up an economic system in such a way that it represents a solidarity space.”

François Perroux defines the concept of integration by means of Western European integration. “The act of integration unifies the elements in order to create a whole or it increases cohesion of an already existing whole. To integrate Europe will be, supposing that the elements of Europe are its nations, to join all these nations into a whole that deserves – thanks to its cohesion – to be called European or to increase the level of cohesion characterizing a whole that will naturally deserve to be called Europe.”

Integration tries, according to Perroux, to replace national balances created within every European nation, between every European nation and the other European nations and the ones exterior to it, thus creating a more favourable and profitably stable system.

Taking the definition given to Western European integration as a starting point André Marshall considers that this integration is of four types:

- 1) **Economic** – which can result from the multiple and complex economic connections existing between the producers of the member nations: industrial entrepreneurs, bankers, traders, by excluding the national policies coordination or the application of a common policy.
- 2) **Social** – this means that one can accomplish what Myrdal has called “the equality of chances” which implies, contrary to economic integration, the intervene of national and European public powers. If economic integration can be of a private nature, then social integration cannot be conceived otherwise than institutional.
- 3) **Political** – this is accomplished when within Western Europe the unity of leading is reached and the conditions for the creation and functioning of a super-national authority are reunited, thus the wholly integrated system being structured as each nation is.
- 4) **Territorial** - this is the real integration since it is at the same time economic, social and political.

We regret to mention that André Marshall, as well as other economists, omits one of the fundamental integrations that conditions the other four mentioned above – the financial monetary one.

Thus, we appreciate that Perroux’s theory according to which there are three forms of integration is a much more complex one. Perroux mentions the following forms of integration:

- a) **market integration**
- b) **integration by investments**
- c) **integration by institutions**

These forms are actually different stages of the integration process.

Market integration is the simplest form of integration, its aim being to create a common economic and monetary-financial market by eliminating the customs barriers and ensuring the free movement of the goods and the money within the given area. A decisive role in the formation of the common market is played by monetary-financial integration whose most important element is represented by the free convertibility and flow of the currencies.

Economically the unification of Western Europe has meant the creation of an enlarged market which allows economy to function on a superior level, as the American and Asian ones function.

However, expansionist policy characteristic of the big capitalist countries and imperial monopolies hide themselves behind phrases like “the great inter-territorial unity”, “optimal dimension”, and this happens to the disadvantage of the small states whose natural wealth, economic and political life are threatened.

Another argument that is frequently referred to by economists to justify Western European integration is the development of the production forces and the fast contemporary technical progress.

André Marshall considers that integration is unconceivable in its structural sense unless we take into consideration the following conditions:

1. Geographical closeness – statistics point out that neighbouring countries practice a more intense commercial exchange and that distance still represents an obstacle in encouraging economic exchange despite of the progress made as far as transport means are concerned. He stated that: “one can find here one superior characteristic of UEM over the free exchange including: Austria, Denmark, Norway, Portugal, Great Britain, Sweden and Switzerland.”
2. Comparable development levels and homogeneity of structures. “This means, according to André Marshall, that territorial integrity must unify not complementary economies but similar economies with a view to restructure them in a wider frame; this undoubtedly creates multiple problems and encounters many obstacles but it advantageous. On the contrary, the union of complementary elements which does not generate any problem is useless since all it does is to confirm status-quo.”
3. Psychological conditions: the will to unify and to create a balanced economic complex.

By enumerating these conditions that would make economic integration healthy and politically acceptable André Marshall shows that the integration process cannot be enlarged to include too many countries. That is why one cannot speak of a worldwide integration but only of a regional one.

Myrdal makes an extremely important and correct observation as to the aggravation represented by the regional inequalities in the context of the integration because of the “circular and cumulative causality” mechanism that this implies. The complete liberalization of the exchanges as a consequence of accomplishing the unification of customs, labour force and capital generates a double cumulative process which makes rich regions get richer and the poor ones get poorer.

One has to understand that European integration does not take place in an international “vacuum”. The countries in the European Union are open economies having strong links with the rest of the world. That is why the developments accomplished by the European Union will be seriously affected by the economic and political events outside the European Community.

On the other hand, the EU is an important actor on the world stage, an actor whose actions have a significant impact on the world economic system. All these challenges, evolutions represent the key to progress and the going on competition.

UEM Impact over Capital Market Globalization

The capital liberalization directive adopted in June 1988 regulates the complete liberalization of capital flow in the European Economic Community.

The European Union Treaty adopted by the member states interdicts any restriction imposed to capital flow and payments made between member states and it ensures the endurance of the European integration.

The complete harmonization of the capital market is also hindered by the national characteristics of the monetary markets which are, basically, influenced by the inflation level.

The worldwide trade expansion, capital flows, the unprecedented scientific and technological progress, the transition from the communist economic system to market economy have determined the acceleration of the regional and world integration process,

which actually means the appearance of more business affairs for banks, firms and financial investors.

An overview of these events points out the Eurocurrency market expansion, the appearance and reinforcement of the European Union, the growth in importance of multinational companies, to which one can add financial crises, petroleum crises, the external debt crisis and the collapse of communism in Russia and Eastern Europe.

At the beginning of the 3rd millennium globalization has become a state of facts. Under the given circumstances, the international financial institutions, businessmen will have to face challenges and contempt, the so called “new rules of the game”.

Globalization also implies a series of **positive**, innovating and dynamic **aspects**, and also a set of **negative aspects** that generate problems and create marginalization.

As far as the **positive aspects** are concerned the relationships between states and individuals are now more profound than ever. Today world exports represent 25% of the GDP, in comparison with 17% in 1970.

Foreign direct investments are 10 times higher than in the 1970's. This world integration process is the result of a **political change of perspective**, which means: seeking to promote economic efficiency by:

1. national market liberalization
2. disallowing the state to get involved into several economic activities.

Although recent technological progress in the field of communication is the basic factor that generated the appearance of the globalization process, integration is still partial: *frontiers remain closed especially because of the low qualified workforce.*

However, these tendencies mask a series of contradictions: **great progresses, but also significant delays, shortcomings and inequalities between countries and regions, poverty being nowadays a general phenomenon.** In industrialized countries poverty is masked by means of statistics, one of eight persons faces long term unemployment, life expectancy is below 60 years, and many citizens have a low qualification which does not allow the situation to be improved.

In some countries, the poverty index is quite different according to the region we refer to, as it happens with India, for example, where poverty is twice as big in Bihar in comparison with the region Kerala. At the same time, inequalities between men and women are still shocking. In many developed countries women are almost totally excluded from political life. Women occupy over 30% of the Parliament seats in only five countries in the world, in other 31 states the involvement of women in political life being lower than 3%.

If capital markets collapse then the growth of criminality rate, AIDS spread and the increase of the greenhouse effect risks will propagate in a much easier way. World threats are more and more numerous today and they surpass national and international capacity to react and suppress such phenomena.

The alternation of the expansion and recession stages with those of financial volatility is the main characteristic of the economic and monetary financial environment today.

The financial crisis in Eastern Asia as the present one in the USA, the latter having affected the whole world, has made millions of people's lives unsure and it has reduced development perspectives in America and also all over the world. Analyzing financial crises one can draw the following conclusions:

- a) **First of all lack of stability is a characteristic of globalized financial markets.** A key element that has led to the outburst of the crisis is represented by the massive and sudden injection of short term capitals followed by a similarly sudden withdrawal.

- b) **The second conclusion** that is drawn after analyzing economic crises is that **access to short term capitals should be cautiously offered by governments**, especially when the institutions authorized to regulate young financial markets.

How are the present divergences going to evolve in the next century? Is globalization going to be successful in its aim to maintain balance in a world dominated by intelligence or a Faustian spirit and terrorism? The answer to these questions is to be found some day.

Who will mostly benefit of the change? Under no circumstances the European exchange offices are going to take benefit. The IT sector, the consulting and accounting companies are going to take benefit of the necessity for adapting the existing IT systems. Finally, economy is going to benefit of the integration and stability of the currency, and this is in fact the goal of the project.

As far as capital markets are concerned they have also taken the necessary measures. Securities have been issued ever since 1999 in EURO and the ones that were already issued on the market were converted. The future of the financial centres is regarded differently and for the moment a one cannot make a certain prediction. **If Great Britain joins UEM, London will be able to dominate the capital market.** The smaller financial markets like, for example Bruxelles or Milan, will have to reduce the volume of their activity. If this does not happen, there is a risk for the offshore market in Great Britain to embezzle a part of the financial activity volume generated by the EURO environment. Competition between financial institutions and centres will be more and more intense and as a result alliances on continental markets will appear.

London has an advantage in competition when it comes to financial liberalization, which allows it to take advantage from the natural concentration tendencies that are to be found in financial industry. Using the “opting out” clause Great Britain is at the moment able to avoid the accurate monetary policy and discipline imposed by ECB, London still being an offshore centre. *At the same time* the advantage that London has is step by step being reduced to the advantage of Paris which offers superior collaterals in financial transactions.

As to the products derived from the capital market, the unique currency has determined the unification of term contracts. At the same time the quotation of circular assets in EURO has given the chance to make a better comparison and it has created new possibilities for arbitration.

The potential improvement and successes in the financial field depend on the ability with which UEM accomplishes the complete financial integration of the member states, by creating a uniform system of rules on capital markets and by being as transparent as possible in the quotations and evaluations that they make.

The efficiency and spread of monetary policy and the one referring to the central bank status are interlocked. The impact of external constraints must not be regarded as being an absolute one: no country can totally eliminate the adjustments that it must permanently adopt. Thus, it turns out that **a certain degree of independence** must be permanently preserved and taken into account, **which does not mean isolating from** the globalization process. Economic independence ensures security, decision autonomy and it creates the possibility for a state to make the necessary maneuver when the time comes so that every country could have the chance to step out of the game when it considers that the context is not favourable for it. Economic independence is a matter of national interest and it is a crucial dimension for the most precious capital of any state: the human capital. A country that does not make serious efforts to improve **alimentation, health, education, comfort, civilization** and in general everything that refers to **life quality**, risks to disappear from the geopolitical environment, sooner or later. Today, this is a difficult task to be accomplished because of the inequalities that exist between states.

Two external policies are absolutely necessary:

- **Competitiveness policy;**
- **Cooperation policy.**

Competitiveness policy is the key element when it comes to ensuring the possibility for maneuver. Unless we manage to ensure a satisfying competitiveness level, we are to become a colony or satellite of the economically strong states.

Although initially one said that by allowing currencies to freely float all problems will be solved and that all adjustments will accompany these fluctuations by themselves, in reality controlled floating by central banks has proved to be safer. Yet, this action turned out to be inefficient, too. The coordination of monetary and economic policies is today a necessity for the EU countries and the states belonging to G7 group.

Conclusions

The EURO start – a matter of success and skepticism

“E Day” that is to say the Euro Day is the 1st of January 2002. This was the moment when more than 300 million European inhabitants started to prove that they have something in common: the same exchange currency.

The conversion is the second part of a long process conceived in two stages. *The first step*, the electronic introduction of the Euro, was made in January 1999, when the EU imports and exports were calculated in the unique currency. After January 1st 2002, because of this event, 12 EU states and the tourists that were visiting these states remained without Francs, Deutsche Mark and Pound and they started paying for food, tickets or consuming goods in the new notes of the unique currency.

The transition to a unique currency was not only a problem of currency logistics. The immediate or long term effects, good or bad, are immeasurable.

Skepticism and mistrust – this was the position held by many western analysts after the 1st of January 2002, when the unique currency was adopted.

Naturally, a series of scenarios can be imagined for the future starting from the regulations applied nowadays and the trust credited to the unique currency.

The European unification is, however, more than an alliance or association under the ruling of several super-national institutions. The unification is possible only if the proud EU national entities know how to limit themselves and control their aspirations and if the powers characteristic of the national bodies are consciously delegated within the European Union.

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STRATEGIC LOCALIZATION OF JAPANESE ENTERPRISES IN CHINA — AN EMPIRICAL APPROACH

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Abstract

This paper presents a new framework with the aim to deliver a solid basis for further analysis and discussion about the various forms of localization strategies towards the Chinese market. The localization of Japanese companies in China is still at a low level, although it did progress to some degree. As for “goods”, the proportion of sales within local markets or regional markets is still low. As to “manager”, local staff is rarely promoted to managerial positions. As to “capital”, funds are still procured from Japan. The success of Japanese companies depends on deciding on the right localization strategy or the right localization strategy mix bearing in mind the particular circumstances of the Chinese markets. Different factors influence the decision-making process of the strategic Japanese management style, such as new competitors, strong suppliers, and new technologies etc. Based on this theoretical understanding the main objective of Japanese companies should be to strengthen their capability building that aims for better technology and quality. To reduce costs and to enhance access to local markets and the regional market in China, R&D and the development of products intended for Chinese local markets should be strengthened. At the same time, it will be essential to nominate local staff who is familiar with domestic conditions to the ranks of top management in Japanese enterprises more frequently than now. At the same time, the Japanese companies should develop their strategic management in order to make the most out of the long term capability building. However, the most important question for a successful localization strategy of Japanese companies in the Chinese market is still if and how China's economy will continue to develop against the background of the difficulties in the political and social system.

Key Words: *localization; anti-Japan moods; Local Business Know-how; Local Crisis Management Organization; Japanese Brand Image*

Introduction

The People's Republic of China has gained increasing importance as a market and production base for the internationally active Japanese industry. At the same time Japanese companies represent one of the most important backers of China's economical and technological development. Simultaneously, complicated political issues that are difficult to deal with exist between Japan and China, such as historical issues, issues related to Taiwan and so on. Those issues are not ones that can be settled if one party compromises, and cannot be settled easily. In other words, the concern of anti-Japan moods consequent from these problems as a background situation will persist for some time.

Therefore, what sort of localization strategies should Japanese companies pursue in China; a country that is undergoing drastic economic development and with a physically powerful anti-Japanese mood? In this paper, the analysis starts from the question of why Japanese companies are attracted to China and focuses on discussing how these new developments and changes in the Chinese market will impact on Japanese companies' localization process based on the analysis from my research and the filed survey of Japanese companies in China, which was done during April 2006 through September 2007.

Literature Review

Basic theoretical understanding tells us that a company must manufacture a product that is valued by consumers in order to make a profit. Thus, we say that companies should engage in the activity of value creation. A firm's business strategy is defined as the actions that managers take to attain the objectives of the company (Porter 1986), that are actions to reducing costs of value creation (low-cost strategy) or to differentiating its product (differentiation strategy) (Porter 1980, 1985).

For a theoretical approach to the complex subject of localization strategies towards the Chinese market, it is useful to think of the company as a value chain composed of a series of distinct value creation activities including production, marketing, materials management, research & development (R&D), human resources management, information systems, and the firm's infrastructure. We can categorize these value-creation activities as primary activities and support activities (Porter 1985). Both the primary and the support activities are important to improve a firm's profitability: business strategy is the key. It is the most important consideration that the company and its employees have to bear in mind, in order to attain the fundamental objective of any business, to make profit.

If we are following Porter's theoretical understanding, expanding to international markets (in our case to China) allows companies (in our case Japanese companies) to increase their profitability in ways not available to purely domestic enterprises. Therefore Japanese firms are able to earn a greater return from their distinctive skills, or core competencies, and realize a greater experience curve economies, which reduces the cost of value creation. Also, Japanese companies can realize local economies by dispersing particular value creation activities to those locations in China where they can perform the value creation most efficiently, for example labor-intensive industries in western China with a huge supply of unskilled and inexpensive labor. The term 'core competence' refers to skills within the firm that the competitor cannot easily match or imitate (Hamel and Prahalad 1989). These skills may exist in any of the firm's value creation activities, that is R&D, production, human resource management, marketing, general management, information system and technology, and so on. Such skills are typically embodied in products that other firms find difficult to match or imitate: it is difficult, for example, for Chinese companies to imitate products, production technology or the management know-how from Japanese companies operating in the Chinese market. Once again, according to the theoretical view of Porter (1985), the core competencies are the bedrock of a firm's competitive advantage. They enable a firm to reduce the costs of value creation and/or to create value in such a way that premium pricing is possible.

What does all this mean for the internationally operating Japanese Company that is trying to be successful in China? In brief, it means, that the Japanese firm will benefit by shifting each value-creating activity it performs to the location in China where economic, political, and cultural conditions, including relative factor costs, are most conducive to the performance of that particular activity.

Theoretical Background

We can classify the motives for Japanese companies to develop and implement business strategies towards China as resource-seeking and market seeking. These two basic motives of Japanese companies towards China stand behind the fundamental purpose of any business firm to make a profit. We had a theoretical approach on the two basic business strategies to attain the main objective of any firm: reducing costs of value creation (low-cost strategy) or differentiating the products (differentiation strategy).

Many Japanese companies have moved into China as the Chinese economy has grown. Before the 1990's¹ the so-called "taking-back type business" constituted the mainstream in which products assembled in China are exported to Japan and third countries. However, when two-digit growth was achieved for four consecutive years, from 1992 to 1995, companies emerged that moved into China by regarding China as a market for sales.

At the beginning of 2000, China joined the WTO² which means that the Chinese market was totally opened. This has led to a consumption boom chiefly in the coastal areas. Recently, most Japanese companies moving into China intend to promote sales activities with the Chinese market as their target. However, sales activities for the changed Chinese market are significantly different from the "take-back type" business style. To promote sales activities in the Chinese market, business localization must be resolutely implemented. With respect to the personnel management as well, a transition from the labor management type to the human resource development type is also necessary.

There are many cases that the delays in becoming aware of the necessity of localization³ exist among Japanese companies nowadays. Obviously, the reason is because the successful experience in the "take-back type" management is too strong. The construction of factories in China in a "take back type" business style essentially means the operations of factories in China, even though such operations are part of the management of a company moving into China.

While this is not the only issue, many Japanese companies are facing tough challenges in the business of selling products in Chinese market. In other words, although China's attractiveness as a market is increasing as the result of a growing economy, many Japanese companies are not benefiting from such growth. They should lose no time in drastically changing their management style.

Current Status of Japanese companies in China

1 A Contradiction Feeling about Japan

As we all know, anti-Japanese demonstrations occurred in Beijing on April 9, 2005. It then spread to Shanghai, Tianjin and Hangzhou on April 16, and to Shenyang, Xiamen, Guangzhou, and Shenzhen on April 17, causing great bewilderment among Japanese people. Following these affairs, there remains some influence such as sporadic labor-management disputes and the avoidance of order placement for, especially, public goods made by Japanese companies.

The problem is that such anti-Japan feelings may emerge and become a major crisis to the management of Japanese companies in China. The most important features of this issue are that the people who took the lead in the anti-Japan protests were members of the younger generation in their twenties and thirties. Via the interview at Chinese universities, we also observed the keywords "contradiction" may easily express Chinese students' feelings about Japan⁴. In fact, many Chinese people have studied in Japan such as, myself, and their experience in Japan was used as a model in numerous fields such as politics, economy, diplomacy, and science and technology in the modernization process in China. In addition, some Chinese students have favorable images about the Japan due to the result of the survey, such as that Japanese people are diligent, keep their promises, create excellent products, and

¹ The Tiananmen Square protests of 1989 were a series of demonstrations led by students, intellectuals and labour activists in the People's Republic of China between April 15, 1989 and June 4, 1989.

² World Trade Organization.

³ Creating mechanisms for the development of local human resources.

⁴ In China's history education, Japan is referred to as a nation that invaded China during wartime and, at the same time, as a model of success in the modernization of Asia during the postwar restoration.

cultural items such as movies and music.

Conversely, news and articles about Japan's political leaders reported by the Chinese media regarding political issues are contrary to such favorable images, making it difficult for young people to understand the contradictions posed by these aspects. Many young Chinese are not anti-Japanese as far as every particular aspect is concerned. They joined the anti-Japanese demonstrations with mixed feelings. The slogan of "do not buy Japanese products" used in the anti-Japan demonstrations was to express criticism of the Japanese government and, particularly, the issue concerning the visits to Yasukuni Shrine by political leaders. Overall, young Chinese people discriminate between political activities and daily activities. It is not the case that the majority of young people are influenced by anti-Japanese education and practice blind nationalism.

In Japan, some people tend to attribute all of the feelings about Japan to a patriotic education provided by the former Chinese government. However, the "contradiction" may be further expanded if this phenomenon is too greatly simplified in dealing with the issue. In considering future Japan-China relationships and business activities of Japanese companies in China, it is necessary to expand the understanding of the feelings about Japan further among Chinese people⁵ as described in this section.

2 Impacts on Japanese Companies

The issue of feelings regarding Japan has emerged as a new business risk. Because this issue has a complicated background, it is expected that this problem will persist for some time. Until now, no cases have been reported in which the issue of feelings about Japan exerted a major impact on the business activities of Japanese companies in China. However, in assuming that this issue will continue for a long time, attention should be paid to it by Japanese companies.

In April, when the anti-Japanese demonstrations took place, sales representatives of a Japanese manufacturer who I interviewed⁶, went the rounds of its stores in the response to information that its products were being withdrawn from stores. They found that other competing foreign companies and domestic companies were strongly urging storeowners to "withdraw Japanese products from their shelves" and passing out leaflets.

In the case of tenders for some public works projects to which high political attention is paid, Japanese companies sometimes received disadvantageous treatment. Even if these issues do not cause severe damage, it is important to prepare remedial measures and manuals during ordinary times by assuming that these problems might occur again. It is also important to build social trust and confidence in a company in its daily activities as a measure for avoiding risk.

During an interview, a Chinese professor noted that, "We hope for the realization of a superior Japanese management model in China. A model in which labor and management are united to conduct business operations can serve as an important direction that Chinese companies should pursue in the future. This is because we have major concerns over labor-management problems in China. If a Japanese company can achieve pioneering management techniques in terms of these aspects and can provide a model, such a company will be highly regarded." The most effective preparatory measure for avoiding potential risks is that individual Japanese company generously exercise the expertise and skills they can be proud of in China and earn respect in China.

Because many Chinese people have confidence based on the economic development they have achieved in the past ten years or more, attention should also be given to such confidence. In Shanghai alone, more than 30,000 Japanese people live there if long-term

⁵ Especially, the younger generation.

⁶ Please make a reference at the filed survey abstract.

assignments are included. On a daily basis, they are required to behave in a manner that will earn the respect of the local society.

Localized Strategic Action Required for Japanese Enterprises

1 Strengthening Local Business Know-how to Respond to Changes

In order to improve the ability to respond to business risks in China, what is first needed is to equip an organization with the ability to flexibly respond to sudden environmental changes. For example, measures to deal with the shortening of a product life cycle include the diversification of production methods. Specifically, these include increasing the operating rate of production facilities to recover investment as quickly as possible, reducing plant investment as much as possible, and utilizing outside companies by use of OEM⁷ components if appropriate.

Moreover, in order to strengthen the ability to respond to changes in distribution channels such as a shift from existing channels to major volume retailer channels, measures required include strengthening a company's commitment to distribution channels and increasing the control of the information flowing in distribution channels.

Moreover, while this has become common, Japanese companies in particular face a major problem of hiring and retaining skilled personnel. Although some reports indicate that difficulties have been encountered in hiring workers, there is a more than abundant simple work force even in the coastal areas as represented by workers from the rural areas. Rather, the serious problem is how to secure human resources having the necessary expertise and high level of technical background. The struggle among companies to obtain skilled personnel will become increasingly intense.

To improve the ability to respond to such changes, it is necessary to strengthen local business know-how enabling quick decision-making according to situations based on information collected at the local site. This requires the provision of integrated management functions covering development, manufacturing and sales to the local site and localizing the planning functions by developing Chinese managers. For business operations in China, strengthening local business know-how is the best way for Japanese company's to respond to changes in the future.

2 Establishing a Local Crisis Management Organization to Control Risk

In light of the response to the feelings about Japan as discussed in the preceding chapter and the past SARS⁸ outbreak as well, it is important to "establish a crisis management structure for unexpected situations" as a method of helping to deal with risks in doing business in China. The fundamental factor of crisis management is to instantly collect accurate information at the local site and to make a quick decision at the local site. This calls for the localization of an organization. Moreover, an instruction manual should be prepared that indicates the actions to be taken by each organization if a problem, unfortunately, occurs. This manual should be systematically disseminated throughout the company by means of internal company communications.

In addition, the need to increase organizational sensitivity with respect to the possible occurrence of a problem, the degree to which advance studies were made on a series of remedial measures demonstrated basic differences between these two companies. These differences included measures to deal with distribution channels, consumers, and the mass media.

⁷ Original Equipment Manufacture.

⁸ Severe Acute Respiratory Syndrome.

Currently, some Japanese companies are studying remedial measures within such organizations as crisis management committees consisting of local and head-office members established for business in China by detecting indications of risks on a routine basis rather than when a problem occurs. The involvement of top management in risk issues has brought about the effect of increasing overall organizational sensitivity to risks in those companies. This is one of the good examples to explain the importance of establishing a local crisis management organization to control risk.

3 Accelerating Strategic Localization to Create Japanese Brand Image

In addition, to a structure for crisis management, it is also important to work through the media to obtain a correct understanding of business activities by consumers and other relations in China.

The media environment in China is extremely complicated with many TV stations, newspapers and internet portal sites. There are about 300 TV stations (about 3,000 channels), about 2,000 newspapers, and about 9,000 magazines. While circulation of official organs as represented by the People's Daily is decreasing, the circulation of evening papers, tabloids and amusement papers carrying TV programs and entertainment and sports information is increasing.

With the number of users exceeding 100 million people, the Internet has come to have a vital role in forming public opinion. While past use was limited mostly to some younger people and people in the higher income brackets, the Internet is now being used by people at numerous age segments. The number of users is increasing not only in the coastal areas but also in the provincial areas. At the same time, the number of female users is also increasing. If negative information about a company is posted, the article is transmitted through the Internet and copies are instantly made available. Consequently, information⁹ is disseminated in an instant. Recently, there have been many cases where a consumer's complaint about a company spread through the Internet from one area to all of China.

The organs carry the official views of the government, and the tabloids surprisingly have only limited sources of information, and are under the management of the government. However, countless pieces of information flow through the Internet because of the advantage of anonymity. Recently, a bribery case was prosecuted with an indication through the Internet serving as the initial reason for such prosecution.

While keeping daily relationships with the media is costly, any widespread damage caused by the dissemination of negative information may be enlarged to several dozens of times the public relations cost of telling the company's side of the story. Accordingly, it is important that a company establish relationships with the media on a daily basis at least to ensure that the articles are written based on accurate information.

In particular, strong Internet contact should be a part of any company's public relations activities. First of all, information should actively be disseminated in China concerning the company's management policy, business activities and contributions to the local community. This can be done through a company's website to promote an understanding of the appropriate company image.

The representative measures through assuming increased business risks are discussed above. However, while measures to deal with risks must be carefully prepared, they have no meaning if the mindset of dealing with business in China becomes passive. Recently, conversations have emerged that critical feelings and/or opinions about China have started to appear among management executives at head offices in Japan, and this atmosphere is propagated to their local organizations in China. However, the total amount of trade between

⁹ This is most often negative.

Japan and China has already surpassed that between Japan and the United States. The relationships between Japan and China have developed into one that can be called a community. The development of China under international rules such as WTO will benefit many Japanese companies.

With the growing scale of risks, many of the measures against risks cannot be implemented without commitment of the head office in Japan. I hope that the head offices are united with their local offices to re-establish a strategy for China that is appropriate for the new competitive era. I believe that most Japanese companies should accelerate strategic localization to create Japanese brand image in Chinese market as soon as possible. Otherwise, the chance will be lost and never come back.

Conclusions

When considering entering the Chinese marketplace, Japanese companies can never do too much planning. On one side of the coin, China is a market ripe with opportunities due in part to its strong labor force and low cost of doing business. But the other side of the same coin shows that it is important not to take Chinese culture lightly.

It is not by happenstance that China has grown to be an emerging economic giant. The Chinese have a long history and are a very proud people. To underestimate them by not appreciating the degree of sensitivity that goes into their society is a dangerous proposition. In fact, if no action is taken to improve the current situation, these problems may become even more serious in the future. Fundamental solutions to these problems will come from a deepening mutual understanding from each other. Learning from history is the work of learning from the past and, at the same time, is the work of burying past evils.

This is what I have mainly gained from the field survey both in Japan and China. Through this article, I want to share it with those Japanese companies who are trying to enter the Chinese market.

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ISSUES IN KSU FACULTY PUBLICATION ARCHIVING & ACCESS

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Abstract

The present study examines the King Saud University Repository (KSUR) and explores how documents are collected, classified, curated and preserved, and how the digital content is accessed. Although the repository has a total of 48789 file URL's, the proportion of faculty's full-text publications contained in the repository is very small. Faculty publications are stored in folders and subfolders, which are given serial numbers, not fields and subfields. Documents in the KSUR cannot be accessed through the university library website and no link to a special website with a main page, simple and advanced searching tools and multiple keyword narrowing options is available. Faculty publications can be only accessed through Google or Google Scholar by using an author's name as a search term. The Arabic document content is unreadable and 70% of an abstract is simply deleted. When articles uploaded by the faculty in PDF format are located in Google or Google Scholar, they appear in WORD not PDF format. Use of faculty publications is not protected by copyright law. Detailed results are reported and recommendations for storing, retrieving, and accessing the KSUR are given.

Key words: *KSU repository, metadata, access, searching options, digital documents, digital archives.*

Introduction

An Institutional Repository (IR) is an online locus for collecting, preserving, and disseminating the intellectual output of an institution. It includes research journal articles, preprints and post prints undergoing peer review, and digital versions of theses and dissertations, administrative documents, course notes, or learning objects. A repository is also a place where multiple databases or files are located for distribution over a network (Bruce, 2005; Wikipedia).

The primary purpose of an IR is to help create global visibility for an institution's scholarly research, collect content in a single location, provide open access to institutional research output and metadata, store and preserve other institutional digital assets such as unpublished dissertations or technical reports. Institutions see repositories as a way of displaying their output. They enable easy access to research outputs and link e-prints to other working papers and datasets within an institution (Bruce, 2005; Wikipedia). Repositories are important for helping universities and colleges manage and capture institutional assets as a part of their information strategy. A digital repository can hold a wide range of materials for a variety of purposes and users. It can support learning, research and administrative processes. Colleagues use repositories to share and re-use learning and teaching materials (Hayes, 2005).

Within teaching and learning, IRs ensure the availability of content to improve the quality of the learning experience and cater for different learning styles among the students. Repositories could stimulate culture change in teaching and learning, as instructors have to review how they deliver their courses and focus on the improvement of the quality of the learning experience (Hayes (2005).

Repositories are just a new technology (Bruce (2005). When asked how long their IR has been operational, 52.1% of respondents with operational IRs cited 12 months or less, 27.1% from 13 to 24 months, 4.2% from 25 to 36 months, and 16.6% for more than 36 months (Markey and others, 2007). Pilot tests and operational IR's were very small. It was

also found that 80% of the pilot-tests and 50% of the operational IR's contained fewer than 1,000 digital documents. Only 8.3% pilot-test IRs and 19.4% operational IRs contained more than 5,000 documents (Markey and others, 2007). With the rapid increase of IRs, material is now stored in an institutional rather than a national repository. National repositories are 'harvesting' institutionally based digital material for storage in their national repositories.

For the above reasons, many academic libraries are actively involved in building IRs of the institution's books, papers, theses, and other works which can be digitized. Research universities lead in the implementation of IRs. Since 2004 rapid growth in IRs has been seen. In 2004, there were 40 IRs in the U.K. Out of the top 20 research institutions, 15 had IRs, others were being planned (Bruce 2005). Of the 446 academic library directors and senior library administrators who participated in the MIRACLE Project, 52.9% had done IR plans, 20.6% were only planning for IRs, 15.7% were actively planning and pilot testing IRs, and 10.8% implemented an operational IR (Markey, Karen; Rieh, Soo Young; St. Jean, Beth; Kim, Jihyun; & Yakel, Elizabeth, 2007).

In the UK, the Joint Information Systems Committee (JISC) (2005) carried out the MIDESS Project to explore the development of a digital repository infrastructure, the management of digitized content in an institutional and cross-institutional context. For that purpose, an on-line questionnaire was designed and publicized throughout the MIDESS partner Universities: The University of Leeds, University of Birmingham, London School of Economics (LSE) and University College of London (UCL). The goal of the online questionnaire was to identify how respondents were creating, storing and using digital material; to identify the digital content created by academics; to define the level of expertise in creating and using digital material; and to explore the requirements of creating and using digital material. It was found that a large number of respondents had either used or developed digital material. The technology used to create digital material was sufficiently mature and many university staff felt confident in creating their own digital content without requiring a lot of support. Results also revealed the need for developing digital repositories to assist with the management of digital content at the departmental and institutional levels. Key requirements included the ease of adding digital material to the system, availability of long-term storage, the ability to password-protect or restrict specific digital collections, the ability to search across collections, managing metadata schemas effectively, and providing easy access to digital material, and provide support throughout the entire digitization, storage and material location process.

The Library Consortium of New Zealand (LCoNZ) launched a project to establish a multi-institutional research repository to support the Auckland University of Technology (AUT), University of Waikato, Victoria University of Wellington, and the University of Otago libraries working collaboratively to implement an Information and Resource Access Management System (IRAMS). The Project Report made a number of recommendations to ensure that LCoNZ is moving forward with IRR applications in a collaborative way while acknowledging the immediate needs and priorities of each member institution. Those recommendations included: (i) Preparing a Phase II Project proposal with the expectation that DSpace is the most feasible open source digital repository software system for the majority of LCoNZ member institutions, (ii) involving information technology (IT) Directors from each member university to assist with the preparation of the Phase II Proposal and in particular to articulate the advantages, disadvantages and cost estimates of a shared, remotely hosted technical solution and (iii) to meet the immediate needs of each university in the interim period before a functioning LCoNZ solution becomes available (Shepherd (2007).

A yearlong study of faculty members at the University of Rochester has revealed some of the reasons why current IR systems are more useful in theory than in practice and has resulted in modifications to the University of Rochester's implementation of the DSpace

repository software code to better align the repository with the existing work practices of the faculty. The findings have also caused a complete rethinking of how to explain and promote the IR (Foster & Gibbons, 2005).

In Riyadh, Saudi Arabia, King Saud University (KSU) launched a new portal in September 2007. A website with standardized components and tools was created for each of the university's 4600 faculty members in its 32 colleges using the Microsoft Sharepoint software. To help disseminate knowledge, the university faculty were requested to upload their publications, conference presentations, course materials and reports in PDF format, which were then archived in a pool of documents, i.e. the KSU Scientific Repository (KSUR) (<http://reference.ksu.edu.sa>). The KSU Scientific Repository is a rich source of documents and publications. It contains conference presentations, IT papers, KSU journals, research material from the different disciplines in HTML format. Each folder contains self-explanatory subfolders that contain lists of scientific documents and presentations.

The present study aims to describe the following: (i) Whether the KSUR is publicized; (ii) the KSUR administration; (iii) the KSUR content (who is in charge of document supply, input and output formats, kinds of metadata information provided, sharing of digital content, and copyright issues); (iv) how the KSUR is accessed and what searching tools and narrowing options are available; (v) types of technical support and help provided. A sample of randomly selected faculty websites will be examined to find out the frequency of citations, abstracts and full-text publications and conference presentations stored in the repository. The author will search for documents and examine the types of content, file formats, and how digital content is collected, classified, cataloged and preserved. She will examine maintenance, cost, and determine the KSUR system's functionality aspects.

Although the KSUR was created less than a year ago, answers to the above issues will help determine how successful the KSUR implementation has been and whether there is a need for improved functionality. The KSUR policies may not be in place at the time of its public launch. Taking a wait-and-see attitude, evaluating what transpires after a period of time, then firming up existing policies and implementing new ones as needed may be the most expedient course of action.

Subjects

The KSU Repository administrator, 64 faculty members were randomly selected from the 32 colleges at KSU (2 professors per college), and 10 randomly selected faculty websites.

Instrument

Based on the results and recommendations of prior studies by Bruce (2005), the MIDESS Project (2005), Hayes (2005), Shepherd (2007), and Markey, Rieh, St. Jean, Kim, Yakel (2007), a list of Repository features, tools and functionality requirements was made. The KSUR aspects examined included the following: (i) Publicity; (ii) KSUR administration; (iii) content (who is in charge of document supply, metadata information, input and output file formats, copyright, collecting, classifying, preserving digital documents, security and back-up of material, sharing digital content policies); (iv) accessing the digital content and searching tools; (v) technical support, help tools, maintenance, preservation, cost, the system's functionality and storage.

Data Collection and Analysis:

Data were collected using the following procedures: (a) The KSU Scientific Repository administrator was interviewed. (b) The 58 professors were also interviewed to see if they have heard of the new KSU Scientific Repository, if they have used it and what their experience accessing and searching it was like. (c) I performed a content analysis of the KSU Scientific Repository. An actual search in the Repository for the publications and documents of 10 KSU faculty including myself was conducted to determine its functionality. Percentages as well as qualitative accounts are given.

Results and Discussion

Results are reported with regards to several KSUR issues: Publicity, administration, content, access and searching, technical support and help issues.

Publicity Issues

All of the KSU faculty members surveyed in the present study reported that they were unfamiliar with the KSUR, had a poor understanding of file formats, and that they struggled with Repository access through the web.

Administrative issues

Only one computer engineer is in charge of the KSUR. Library staff are not involved in managing the Repository. The administrator has no background in library science and Repository issues. The creation of the KSUR was not intentional. It is a feature of the Sharepoint software where all document links are stored in a locus on the university server. The university has not developed a records storage plan and has not established policies for creating, approving, and enforcing records, including a classification system and a records retention policy. Documents are not classified and stored according to standard operating procedures. The university has coordinated access and circulation of records outside but not within the university. Every month a data map of the new faculty documents is submitted to Google. However, faculty can neither access nor search the Repository through the university portal or library website.

These findings are inconsistent with findings in the Repository literature. For example, Markey, Karen; Rieh, Soo Young; St. Jean, Beth; Kim, Jihyun; Yakel, Elizabeth (2007) found that at least 60% of the have implemented policies for (1) acceptable file formats, (2) determining who is authorized to make contributions to the IR, (3) defining collections, (4) restricting access to IR content, (5) identifying metadata formats and authorized metadata creators, and (6) determining what is acceptable content.

Content and Structure Issues

When the faculty websites were first customized and assigned to them, the technical support team helped all faculty members in digitizing their documents, i.e. converting them to PDF files. A User's manual was available in each faculty website. Authors (faculty members) are in charge of digitizing and uploading their publications and documents to their website. The KSUR has a total of 48789 file URL's. The proportion of the faculty's full text publications uploaded is very small. Only 15% of my publications and documents are stored in the repository. Faculty publications are stored in folders and subfolders, which are given serial numbers, not fields and subfields. Folders and subfolders are not classified according to departments, disciplines, document type, document

language, or fields. Folders and subfolders contain a random collection of articles belonging to different faculty in the different disciplines. A single faculty member's publications are scattered in the different folders and subfolders and he/she would not know in which folders and/or subfolders their documents are stored. Repository content has no metadata associated with their digital material. Faculty are not required to include any keywords when uploading their documents (See Figures 1 & 2).

Figure 1 Sample Folders and Article Groups in the KSUR

| KSU Scientific Reference | | | |
|---|------|--------|---------------|
| Welcome to reference.ksu.edu.sa. This site is a rich source for scientific documents and publications. It contains documents in the standard HTML format, from different branches of science. Each folder contains self-explanatory subfolders that contain lists of scientific documents and presentations | | | |
| Name | Size | Type | Modified Date |
| Articles070898 Click on the link above to access the document, scientific documents, and presentations related to Articles070898 | | Folder | |
| Articles070899 Click on the link above to access the document, scientific documents, and presentations related to Articles070899 | | Folder | |
| Articles070902 Click on the link above to access the document, scientific documents, and presentations related to Articles070902 | | Folder | |
| Articles070903 Click on the link above to access the document, scientific documents, and presentations related to Articles070903 | | Folder | |
| Articles070904 Click on the link above to access the document, scientific documents, and presentations related to Articles070904 | | Folder | |
| Articles070905 Click on the link above to access the document, scientific documents, and presentations related to Articles070905 | | Folder | |
| Articles070908 Click on the link above to access the document, scientific documents, and presentations related to Articles070908 | | Folder | |
| Articles070909 Click on the link above to access the document, scientific documents, and presentations related to Articles070909 | | Folder | |
| Articles070910 Click on the link above to access the document, scientific documents, and presentations related to Articles070910 | | Folder | |
| Articles070911 Click on the link above to access the document, scientific documents, and presentations related to Articles070911 | | Folder | |
| Articles070912 | | | |

Figure 2 Examples of File Types in the KSUR

| KSU Scientific Reference | | | |
|---|------|---------------|--------------------|
| Welcome to reference.ksu.edu.sa. This site is a rich source for scientific documents and publications. It contains documents in the standard HTML format, from different branches of science. Each folder contains self-explanatory subfolders that contain lists of scientific documents and presentations | | | |
| Name | Size | Type | Modified Date |
| Page_1.html | 754 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_10.html | 843 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_11.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_12.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_13.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_14.html | 845 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_15.html | 845 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_16.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_17.html | 846 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_18.html | 845 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_19.html | 845 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_2.html | 837 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_20.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_21.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_22.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_23.html | 846 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_24.html | 845 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_25.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_26.html | 846 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_27.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_28.html | 844 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_29.html | 845 | Web Hypertext | 12/5/2007 12:12 AM |
| Page_3.html | 838 | Web Hypertext | 12/5/2007 12:12 AM |

The Arabic document content is unreadable (appears in gibberish). Abstracts are shortened to few lines. 70% of the abstract is simply deleted. When articles uploaded by the faculty in PDF format are located in Google or Google Scholar, they appear in WORD not PDF format (See Figures 3 & 4).

Figure 3 Example of Output File Format with an Unreadable English Text with Jumbled Print

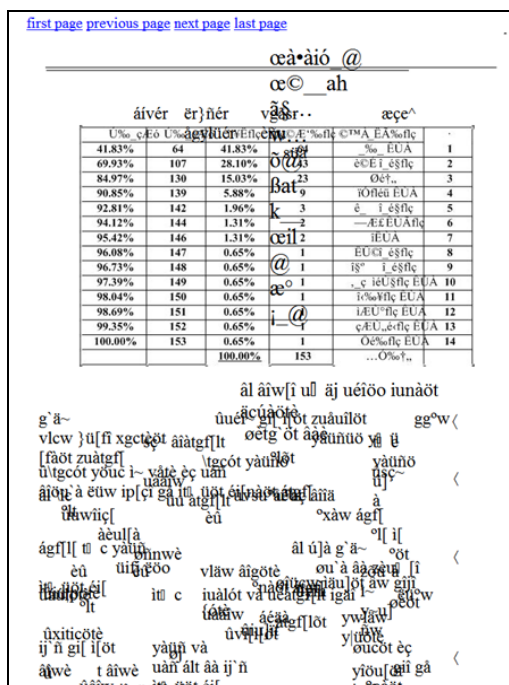
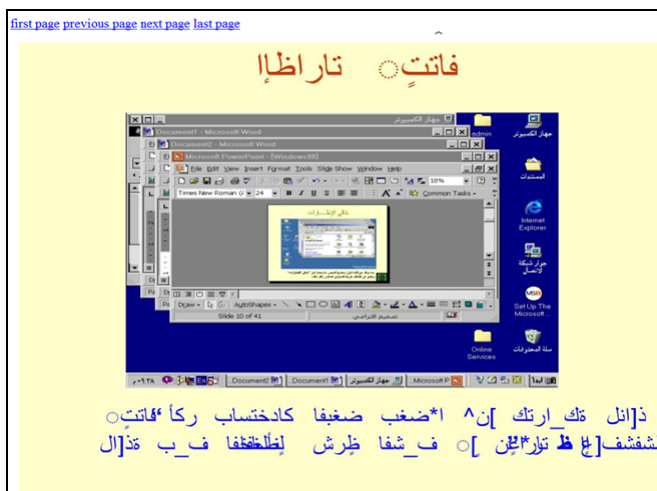


Figure 4 Example of Output File Format with an Unreadable Arabic Text



There is low awareness among faculty, students and the public in Saudi Arabia in general of the availability of external copyright-cleared collections. Respondents tended to rely on search engines such as Google for tracking down external digital images and multimedia materials, but reported information overload when they do so. Access to faculty publications is not protected by copyright law and plagiarism is practiced by some researchers and graduate students in Saudi Arabia. Anybody can access faculty publications. They are not password-protected.

Access and Searching Issues

Documents in the KSUR cannot be accessed through the university library website, i.e. OPACS, electronic databases or any other kinds of electronic document centers. No special link is available with a main page, simple and advanced searching tools and multiple keyword narrowing options. Faculty publications can be only accessed through Google or Google Scholar when an author's name is entered in the search box.

Since documents are stored in folders and subfolders, and are just given serial numbers, it is a waste of time to search those folders and subfolders one by one. The only way to access documents stored in the repository is to search Google, Google Scholar, or Microsoft Scholar by author. Options for limiting the search by language, publication date, document status, document type, document language, or discipline are not available.

Technical Support Issues

A team of 10 support staff provided training and helped faculty solve document digitization and uploading problems. Help is offered by phone or e-mail.

Recommendations

Based on the results and recommendations of Institutional Repository studies by Bruce (2005), MIDESS Project (2005), Hayes (2005), Shepherd (2007), Markey, Rieh, St. Jean, Kim, Yakel (2007), a number of guidelines are given below to help improve the publicity, administration, content (input and output, copy right issues), access and searching options, technical support, functionality of the KSU Scientific Repositories. The KSUR technical and functional requirements, KSUR structure, accessing the KSUR, KSUR searching tools and narrowing option, KSUR copyright laws, KSUR funding, KSUR help screens and guides, KSUR technical support.

Publicizing KSUR

The benefits of the KSU digital Repository should be promoted to the individual faculty, department and college. These include the long term preservation of the material, the ability to easily locate the material and the expected prestige for the individual faculty/department gained by sharing the material. The KSU digital Repository should be publicized and actively promoted throughout the KSU campus (colleges and departments) through presentations, workshops, tutorials, user groups, personal contacts, campus newsletters and students' paper... etc.

KSUR Administrative Requirements

Creation, operation and maintenance of the KSU digital Repository should be supported by the highest level within KSU. The Main Library staff should be in charge of managing the KSUR not the KSU Portal Department. A special Repository Unit may be

established. The KSUR Unit should develop a records storage **plan**. It should establish policies for creating, approving, and enforcing records, including a classification system and a records retention policy. Policies should define the following: (i) acceptable file formats, (ii) determining who is authorized to make contributions to the IR, (iii) defining collections, (iv) restricting access to IR content, (v) identifying metadata formats and authorized metadata creators, and (vi) determining acceptable content. Documents should be classified and stored according to standard operating procedures. The university must coordinate access and circulation of records within and outside the university. Faculty should have access to the KSUR and should be able to search it through the university portal and/or library website.

There should be **funding** for adequate hardware to ensure that the necessary storage space for the digital material is available. Additional funding may be required for more centralized storage. Funding almost always comes from the library.

Technical Requirements of KSUR

The KSUR should have flexible and powerful search facilities. The KSUR needs to be capable of handling a variety of file formats, including still images, sound and video. The input and output formats that the KSU digital Repository supports should be identified to ensure that digital material can be exported and imported into other digital repository systems to ensure portability of data. They must be able to interoperate with other administrative systems, portals, other repositories, and they must not lock their content into systems from which it is difficult and expensive to extract. The KSU Digital Repository should interface to other systems, including the VLE, Portal Library System, Intranet etc. KSU must coordinate access and circulate records within and outside the university. The KSUR should connect to, and be accessible from, other systems within KSU such as the KSU Library system, the Virtual Learning Environment (VLE) and university portals. The KSUR infrastructure needs to be flexible enough to enable the creation and management of a variety of metadata schemas to meet different needs across the subject disciplines. Bulk upload facilities for images and other content should be provided. The most appropriate metadata schemas for the digital material should be identified and these should be discussed with the faculty depositing the digital material. Agreement should be also made as to who enters the appropriate metadata for each digital object. The KSU Repositories should be primarily designed to hold collections of static objects, in addition to metadata information relating to those objects.

It is important to define the scope of the KSUR, determining what will be included in it and what will not, this would allow the KSUR administrator to make an estimate on the amount of data, its likely growth and costs. Once the digital objects have been added to the Repository, the following questions should be addressed: (1) Who owns the collection of digital material added to the KSUR? (2) Who has the rights to add, modify and delete material from the KSUR collection (the administrator, the depositor or others?); (3) who is responsible for entering the metadata corresponding to the digital object (the depositor, a Library staff or specialized personnel?); (4) Who has a detailed understanding of the digital subject matter being deposited? (5) who is the owner of the deposited collection? (6) depositors wish their material to be used in the digital repository?

The KSUR Structure

A Repository is a database. Users of a Repository database need a quick and efficient means of finding published materials in the database, such as articles on a given topic. Most electronic databases have similar features and functions. Thus the Repository consists of records which are whole units of information. There are usually thousands of records in a database. Records are divided into smaller units of information called fields. A record and

each bit of information is a field. Typical Repository fields include author, title of the article, journal title, publication date, subject headings, and abstracts all of which are searchable. Each record in Repository must represent one thing, include the citation, and include an abstract or even full text.

Accessing KSUR

By networking a database a number of users can search the same database simultaneously. The database should be available at workstations in the Main Library and Departmental and College Libraries. It should be available to KSU faculty and staff who can access the KSU's home page from their office PC, or from home if they have dial-in access to the KSU. KSU students who have joined the Electronic Campus service may also access it from home and from some computer labs. The Databases page must direct users to the relevant electronic resources for the various subject disciplines. General information is provided on each database, as well as help screens for searching techniques.

Boolean operators AND, OR, and NOT, Keyword searching, Controlled Vocabulary and Field Specific Searching (title, author, subject, journal or source, publication year, dates covered, source, identifiers, ISBN, ISSN, institution, sponsoring agency, descriptors, type of publication included, language, abstract, publication format) should be added to the KSUR. A field-specific search is used when users are looking for: (i) articles in a particular journal, (ii) items published in a particular year or years, and (iii) publications written by a particular person). Types of search (Basic and Advanced search) and how results are displayed must be also taken into consideration.

The user should be able to search the repository by author; publication title; subject area (science, math, engineering, medicine, history, geography, education...etc); item type (any publication, journal article, book, book review, book section, monograph, proceedings, serials, computer program, dissertation/thesis, creative works, guides, patents, artifact, non-print media, image, audio, video, dataset, bibliographies, catalogs/directories, reference materials, reports, tests, questionnaires, translations, teaching resource, historical materials, other); publication date; college/department; editors; status (published, in press, submitted, unpublished); type of results (full text, abstract or citation), order of results (by year most recent first); ability to print, save or e-mail results; ability to go back to previous search screens or to the main page (See Figure 5 for a sample of repository fields and searching options).

Users can access the document citation and abstracts, but access to full-text articles may be a Repository password.

KSUR Copyright Laws

Before submitting digital material to a KSU digital repository, the potential depositor of digital material and the administrator of the digital repository need to be clear that the material submitted does not breach Copyright and both need to be clear what the potential use of the material will be once it has been deposited in the KSU digital repository. Copyright must be made clear. Some material needed to be closely restricted for data protection reasons such as medical and space images. Some content can be password-protected.

Figure 4 Examples of Advanced Search and Narrowing Options from ePrints Soton Repository Software

home

my eprints

browse

search

e-Prints Soton

University of Southampton

Advanced Search

Leave the fields you don't want to search blank or [Click here](#) for a simple search.

Item ID

Enter a single number (e.g. 93), or a range of numbers, e.g. '17-23', '17-' or '-23'.

Refereed

Select a value.

No Preference

Full Text

Enter a term or terms to search for.

Match all, in any order

Title

Enter a term or terms to search for.

Match all, in any order

Authors/Creators/Editors

Enter a name or names to search for. Either the family name, or the family name followed by a comma and the first name or initial. Names with spaces may be indicated by surrounding them with double quotes, eg. "van Damme, J".

| | |
|---|-------------------------|
| | Match all, in any order |
| Authors/Creators | |
| Enter a name or names to search for. Either the family name, or the family name followed by a comma and the first name or initial. Names with spaces may be indicated by surrounding them with double quotes, eg. "van Damme, J". | |
| | Match all, in any order |
| Editors | |
| Enter a name or names to search for. Either the family name, or the family name followed by a comma and the first name or initial. Names with spaces may be indicated by surrounding them with double quotes, eg. "van Damme, J". | |
| | Match all, in any order |
| Date | |
| Enter a date or date range. | |
| Examples: "1985-", "2001-05-17-2002-05-16", "-11-1980" | |
| | |
| Abstract | |
| Enter a term or terms to search for. | |
| | Match all, in any order |
| Uncontrolled Keywords | |
| Enter a term or terms to search for. | |
| | Match all, in any order |
| Journal/Publication Title/Series Name | |
| Enter a term or terms to search for. | |
| | Match all, in any order |
| School or Centre | |
| Select one or more values from the list, and whether you want to search for records with any one or all of those values. Default is (Any). | |

| | |
|--|--|
| Faculty of Engineering, Science and Mathematics | |
| Faculty of Engineering, Science and Mathematics: Institute of Sound and Vibration Research | |
| Faculty of Engineering, Science and Mathematics: Institute of Sound and Vibration Research: Dynamics | |
| Faculty of Engineering, Science and Mathematics: Institute of Sound and Vibration Research: Fluid Dynamics and Acoustics | |
| Faculty of Engineering, Science and Mathematics: Institute of Sound and Vibration Research: Human Sciences | |
| Faculty of Engineering, Science and Mathematics: Institute of Sound and Vibration Research: ISVR Consulting | |
| Faculty of Engineering, Science and Mathematics: Institute of Sound and Vibration Research: Signal Processing and Control | |
| Faculty of Engineering, Science and Mathematics: School of Chemistry | |
| Faculty of Engineering, Science and Mathematics: School of Civil Engineering and the Environment | |
| Faculty of Engineering, Science and Mathematics: School of Electronics and Computer Science | |
| Faculty of Engineering, Science and Mathematics: School of Electronics and Computer Science: BIO@ECS Research Group | |
| Faculty of Engineering, Science and Mathematics: School of Electronics and Computer Science: Communications Research Group | |

Any of these

Subjects

Select one or more values from the list, and whether you want to search for records with any one or all of those values. Default is (Any).

A General Works

A General Works: AC Collections: Series. Collected w orks

A General Works: AI Indexes (General)

A General Works: AM Museums (General). Collectors and collecting (General)

A General Works: AS Academies and learned societies (General)

A General Works: AZ History of Scholarship The Humanities

B Philosophy, Psychology, Religion

B Philosophy, Psychology, Religion: B Philosophy (General)

B Philosophy, Psychology, Religion: BC Logic

B Philosophy, Psychology, Religion: BD Speculative Philosophy

B Philosophy, Psychology, Religion: BF Psychology

B Philosophy, Psychology, Religion: BH Aesthetics

Any of these

Item Type

Select one or more values from the list. Default is (Any).

| |
|-----------------------------|
| Article |
| Book |
| Book Section |
| Conference or Workshop Item |
| Monograph |
| Patent |
| Thesis |
| Artefact |
| Show/Exhibition |
| Composition |
| Performance |
| Other |

Status

Select one or more values from the list, and whether you want to search for records with any one or all of those values. Default is (Any).

| |
|-------------|
| Published |
| In Press |
| Submitted |
| Unpublished |

Retrieved records must fulfill of these conditions.
Order the results:

| | |
|---------------------------------------|--------------------------------------|
| <input type="button" value="Search"/> | <input type="button" value="Reset"/> |
|---------------------------------------|--------------------------------------|

KSUR Help Screens and Guides

Most databases have help screens that provide you with important information about searching the database and about what type of information is included in the database. The KSUR should have HELP information by: (i) Having a “Help” link in the main page; (ii) Typing the word help; (iii) Pushing the F1 key or (iv) Typing a question mark.

KSUR Technical Support

Technical support must be available at more advanced levels. It is required for the sharing and use of digital material. Tools that support ease of use for depositors of different backgrounds can be provided. A refining software –offering assisted deposit and fast track, setting up to encourage good citation metadata for future use. Exemplars can be created for faculty to follow.

Conclusions

The KSU Scientific Repository is just a by-product of the Sharepoint software. No intentional efforts, policies, plans are available for creating a Repository on the part of KSU. The current KSUR lacks many features and requirements, is inaccessible from the KSU or KSU library websites, it is only accessible through search engines such as Google and Google Scholar. Since KSUR is a means of displaying the university’s digital assets, Department Repositories, Subject Repositories (repositories containing digital material specific to a subject such as biology, medicine, agriculture, IT, business, education), Teaching and Learning Repositories where teaching material such as computer-based learning courses can be located, Research Repositories which contain both papers and thesis. To be successful, a team of specialists in library and information science must be in charge of the KSU Scientific Repository. IR’s must be first pilot-tested and user needs assessed.

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FRANCHISING: HYBRID ORGANISATIONAL ARRANGEMENT FOR FIRM GROWTH AND NATIONAL DEVELOPMENT

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Abstract

This paper examines the practice of franchising as a strategy by which entrepreneurs can expand their venture and make substantial return from their investments. The paper tries to explore the extent to which franchising is being practiced in Nigeria and the resultant effect of franchising on the national economy. The study was done by taking intensive study of Nigerian business world to see the extent of the practice of franchising system of business. The result of this study shows that franchising is not well known or practiced in Nigeria. Only a handful of business entities such as the Nigerian Bottling Company and some fast food companies have been engaged in franchising. The paper recommends that government should create a greater awareness of the franchise strategy so that more investors will be aware of it and invest in it. This will create more employment opportunities, reduce poverty level, and ultimately improve the Gross Domestic Product of the nation.

Key words: *Entrepreneurship, Franchising, Market, National Development.*

Introduction

A number of strategies are available to the entrepreneur for the expansion of his venture. However, one of these strategies that are mostly ignored by entrepreneurs in new venture expansion is franchising. This paper examines the practice of franchising as a hybrid organizational arrangement by which entrepreneurs can expand their business. This paper is important because proper knowledge and application of franchising business is imperative for firm growth and national development. The author conducted an intensive study of Nigerian business world and discovered that franchising, unlike what obtained in developing countries such as the United States of America where, one out of every three dollars spent by Americans for goods and services is spent in a franchise business. This cannot be said of Nigeria. This is because many entrepreneurs in this part of the world are yet to know the benefits inherent in franchising (Ike-Okoh, 2006).

In this study, we explore what franchising is; we also consider the scope of franchising and examine the criteria for determining a franchise's stature from the perspective of both the franchisee and franchisor. We also look at franchise relationship model. We conclude by examining the current trend of thinking on franchising and how Nigeria business can profit from it.

Literature review

Concept of Franchising

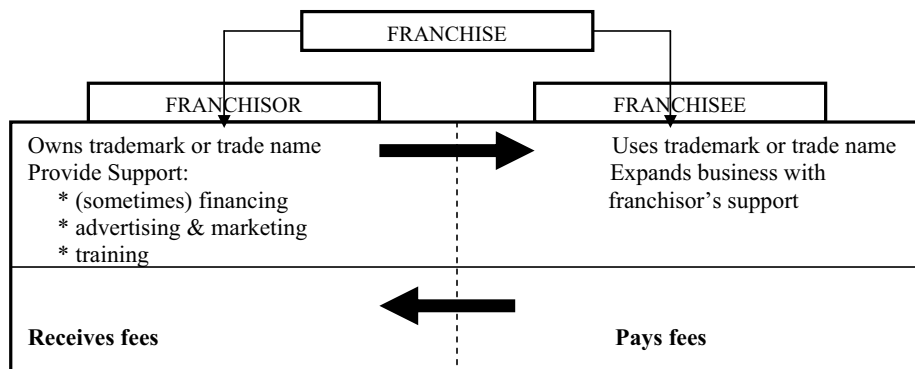
Historically, the word franchise is of French origin. It simply means "privilege" or "freedom". Hisrich, Peters and Shepherd (2005) see franchising as a means of new entry that can reduce the risk of downside loss for the franchise. They see franchising as an alternative

means by which an entrepreneur may expand his business by having others pay for the use of the name, process, product, services and trademark. It can be used as a growth mechanism by the organization (i.e. the franchisor). It is sharing an entrepreneurial vision and working together to make it a reality. According to Otokiti (2004) franchising is a business arrangement in which the franchisor grants the franchisee the right to do business in a prescribed manner over a certain period of time in a specified way. However, franchising can be used to describe business format in which the franchisor offers a complete business package. Thus, Beshel (2001) says a franchise is the agreement or license between two legally independent parties which gives:

- A person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor).
- The franchisee the right to market a product or service using the operating methods of the franchisor.
- The franchisee the obligation to pay the franchisor fees for these rights.
- The franchisor the obligation to provide rights and support to franchisees.

A simple franchise agreement is illustrated in figure 1 below:

Figure 1: A simple franchise agreement



Source: Adapted from Beshel (2001)

It is pellucid from the above figure that both the franchisor and franchisee have rights and obligations to each other.

In order to distinguish it from other forms of agreement, the following important features characterized franchise.

A Contract; a franchise is based on a contract between the franchisor and the franchisee. The contract tells each party what each is supposed to do.

A Purpose; the franchisor and the franchisee agree that their purpose is to provide for efficient distribution of the goods or services.

Resources; the franchisee usually contributes money and agrees to manage the local franchise business to the best of his ability for monetary gain. The franchisor contributes other resources such as business idea, trademark, training, technical know-how, legal framework and advise.

A business entity; there is a separate legal entity. The franchise outlet is set up as a separate business with a distinct identity, different from the franchisee's existing business,

A common public identity; both parties support a common public identity through the use of a common trade name, trademark, architectural design, advertising, and product brand.

A financial arrangement: the franchisee is expected to make a profit from the venture and compensate the franchisor with a franchising fee and royalties as the case may be.

Theoretical Framework of Franchising

The success of the franchisor depends on the success of franchisee. Therefore the franchisor's attempt to select franchisees that will work hard and take the responsibility for their outlets, yet be willing to listen to advise and cooperate (Otokiti, 2004).

Hisrich et al. (2005) argued that not all franchise is right for every entrepreneur. An entrepreneur must evaluate the franchise alternatives to decide which one is most appropriate. Following are the number of factors that should be assessed before making final decision.

- The unproven versus the proven franchise.
- Financial stability of franchise.
- Potential markets for the new franchise.
- The profit potential for a new franchise.

They also argued that entrepreneurs face certain problems in starting up a new venture in areas such as; product acceptance, management expertise, meeting capital requirements, knowledge of the market, and operating and structural controls, but that in franchising, the risks associated with each are minimized through the franchise relationship.

Types of Franchises

There are two main types of franchises: product distribution franchises and business format franchises.

Product Distribution Franchises: According to Beshel (2001) product distribution franchises simply sell the franchisor's product and are supplier-dealer relationships. In product distribution franchising, the franchisor licenses its trademark and logo to the franchisees but typically does not provide them with an entire system for running their business. This type of franchise is commonly found in soft drink distributors, automobile dealers and filling stations.

Although product distribution franchising represents the largest percentage of total retail sales, most franchises available today are business format opportunities.

Business Format Franchise: Stokes (1998) argued that the word franchising is more commonly used to describe business format franchising. This, he said, is seen as a more in-depth relationship between franchisor and franchisee than the simple product distribution or trademark licensing agreement. Business format franchises, says Beshel (2001) not only use a franchisor's product, service and trademark, but also the complete method to conduct the business itself, such as the marketing plan and operations manuals.

Business format franchising represents a complete package that allows the franchisee to use the format proven by the franchisor, whilst retaining independence as a business. There is an agreement between the two parties that sets out how the business will be run and the obligations of both parties. It is an organizational form based on a legal agreement between a parent organization (the franchisor) and a local outlet (the franchisee), to sell a product or service using the brand name developed and owned by the franchisor. The franchisor typically sells the franchisee a right to use this intellectual property in return for a lump sum payment and an annual royalty fee based on sales for a specified period of time (Miller and Grossman, 1990).

In addition, the franchisee usually agrees to adhere to franchisor requirements for product mix, operating procedures and site selection (Robin, 1978).

Business format franchising is a popular example of a hybrid organizational format that incorporates elements of both markets and hierarchies (Williamson, 1991). It is a hybrid alternative since the franchisor both retains a degree of ownership and authority over the use of the trade name, operating procedures and the location of outlets and contracts with independent entrepreneurs to operate the units (Child, 1987).

Business format franchising provides a useful laboratory for examining the effect of hybrid organizational forms on the rate of growth. Franchisors exploit the same retail markets using the same business concepts through both franchised and company owned outlets. Consequently, by looking at franchisors, researchers can examine the effects of organizational format on the rate of the growth of firms holding constant, firm and markets differences (Shane, 1996).

Early forms of franchising were linked to the classic argument that economic organizations follow two general forms, viz: markets and firms (Coase, 1937). Theorists identified franchising as a hybrid manifestation of the two forms because it has both market-like and firm-like qualities (Norton, 1988; Brickley and Dark, 1987, Matthewson and Winter, 1985). Franchising is seen as a means of obtaining scarce capital, as the franchisee is generally required to make a substantial investment on the business.

Franchisees share risk with the franchisor. Franchising is also identified as a way of addressing the agency problem, specifically, the issue of monitoring managers (Brickly and Dark, 1987; Matthewson and Winter, 1985). Franchisees with substantial investments are more motivated to minimize revenues through administrative efficiency and protection of the franchise brand, while minimizing operational costs (Welsh, Alon and Falbe, 2006). The issues of monitoring and risking are greatly increased in international franchising by both geographical and cultural distance (Fladmoe-Lindquist and Jacque, 1995).

Types of Franchise Arrangement

Because so many franchisors, industries and range of investments are possible, there are different types of franchise arrangements available to a business owner. Two types of franchising arrangements are: single-unit franchise and multi-unit franchise.

A Single-unit Franchise is an arrangement where the franchisor grants a franchisee the rights to open and operate only one franchise unit. This is the simplest and most common type of franchise. It is, however, for a franchisee to purchase additional single-unit franchises once the original franchise unit begins to prosper. This is then considered a multiple, single-unit relationship (Beshel, 2001).

A Multi-unit Franchise is an agreement where the franchisor grants a franchisee the rights to open and operate more than one unit. A multi-unit franchise can be achieved in two ways, namely: an area development franchise or a master franchise.

Under an **area development franchise**, a franchisee has the right to open more than one unit during a specific time, within a specified area for instance; a franchisee may agree to open 3 units over a three-year period in a specified territory.

A master franchise agreement gives the franchisee more rights than an area development agreement. Apart from having the right and obligation to open and operate a certain number of units in a defined area, the master franchisee also has the right to sell franchises to other people within the territory. This is known as sub-franchises. Therefore, the master franchisee takes over many of the tasks, duties and benefits of the franchisor, like providing support and training, as well as receiving fees and royalties.

The FRM in figure 2 above illustrates how a franchisor can construct a franchising company and the pathway for implementing it in the most entrepreneurial way.

Current Trends Of Thinking On Franchising

According to Welsh et al. (2006) new symbiotic relationships are created when retail franchising expands into developing countries. Retail franchising allows firms to achieve the expanded reach and efficiencies associated with internationalization more rapidly and effectively than the firms could accomplish on their own. Etemad, Wright and Dana (2001) developed a paradigm called the Interdependence Paradigm to explain these franchise-marketing networks. They said that franchising involves a network of franchisees under the guidance of a parent firm, the franchisor. Franchisors that are well established can achieve greater efficiency by incorporating smaller franchisees from the emerging markets into international franchise networks. It was also pointed out that franchising could help local ownership requirements in regulated sectors. Therefore, franchising enhances the competitiveness of franchisors, while contributing to the development of emerging markets. The symbiotic interdependence that forms between franchisor and franchisees in a network, which is viewed as a paradigm shift from independence to interdependence, have far reaching consequences and have a major impact on the way business is handled internationally.

Franchising in emerging markets also offers the host countries certain advantages. These benefits include obtaining foreign currency with little capital outlay, increases in employment and thereby growth in the franchisor's tax base and gross domestic output. Franchise growth and development spawn entrepreneurial development comprised of small and medium enterprise networks.

Retail franchising may have adverse effects on the host market. It can sometimes supplant traditional and local elements, which over time can lead to homogenization and westernization of preferences, especially among the youth. International retail franchising often times has the effect of displacing local industry. Alon (2004) examined the macro-environmental impacts of franchising on the host and home markets and included in his analysis economic, political and social ramifications. He concluded that the probable overall impact however, is positive in the long.

Governments, according to Welsh et al. (1006) have increasingly become aware of the benefits that franchising has to offer to their country. As a result, many governments are in the process of improving their country's business environment to attract high quality franchises. These improvements have included positive legislation for franchise regulations, trade associations, establishing support organizations, and franchise education programmes.

In recent years, franchisors have built huge portfolios of brand and grouping them to take advantage of retail space. Franchisees too, are learning this approach seeking to spread their costs over a larger business. Those in the business of franchising in Nigeria today are projecting that the franchising market in Nigeria will grow at 10 per cent annually by 2010. This is premised on the level of awareness on the concepts and best practices on franchising, which is presently low (Ike-Okoh, 2006).

Experts, according to Ike-Okah, (2006), say the business format franchise is less exposed to the problem associated with conventional business such as recruiting and retraining staff and the security of stock and cash. That is, it is a system that makes it easier

for companies to expand internationally and some franchise companies are among the largest multinational corporations in the world. A good example is the Coca-Cola Company that operates a franchise through the Nigerian Bottling Company (NBC). Today, NBC is one of the biggest companies operating in Nigeria.

Conclusion

The scope of franchise concept can be local, regional, national, or international (Timmons and Spinelli, 2004). Recent trends in the business environment have brought about innovative ways in which firms can take the lead in their industry even in the face of great competitors. This is because entrepreneurs that are using franchising as business strategy are making big profits and are gaining even stronger brand names through it. By maintaining the same standards operated in the parent company, franchisees stand a great chance of maintaining their customers' loyalties.

For franchising business to gain great ground and popularity in Nigeria and be very good investment for up and coming entrepreneurs, the following recommendations need to be followed.

First, the franchisors should make it easier for aspiring franchisees to come in by not making their royalty fees too large that interested investors would be discouraged to invest. Second, the government should provide entrepreneurs with subsidized grants that would make it easy for them to buy into a franchise system, grow their franchise business, pay back loans and still be profitable.

Third, franchisors and franchises should not focus only on just maximizing profits, but should take into consideration customer care and be given them quality products and service. Finally, the government should create a greater awareness of the franchise strategy so that more investors will be aware and invest in it. This will create more employment opportunities, reduce poverty level and improving the gross domestic product of the nation.

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THE STATUS OF CHURCHES AND PHILOSOPHICAL AND NON-CONFESSIONAL ORGANIZATIONS WITHIN THE FRAMEWORK OF THE EUROPEAN UNION REFORM

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Abstract

The Treaty on the Functioning of the European Union, signed at Lisbon in December 2007, includes, for the first time, an entire article – article 17 – dedicated to the status of churches and non-confessional organisations in the Community framework. Through this disposition, it is recognized the contribution of the religions and the philosophical and non-confessional organisations explicitly into the European Union and, at the same time, the European Union commits itself to maintain “an open, transparent and regular dialogue” with them.

In this paper, firstly, we shall try to analyse which was the juridical position of both the churches and associations or religious communities, and the philosophical and non-confessional organisations before the signature of Lisbon Treaty. In this sense, we shall specially pay attention to the failed European Constitution that, in its article I-52, refers exactly to the status of churches and non-confessional organizations in the European Union. And, secondly, we shall study the contents of the article 17 of the Treaty on the Functioning of the European Union.

Key words: *Treaty of the Functioning of the European Union, European Union, European Constitution, status of churches, status of non-confessional organizations.*

Introduction

Article 17 of the Treaty on the Functioning of the European Union (hereinafter TFEU) can be seen as one of the most significant developments introduced by the Treaty set up to reform the Treaties which had established the European Community and the European Union, which was signed in Lisbon in December 2007, concerning the democratic participation of European citizens. For the first time ever, an article is devoted entirely to the issue of the status of churches and of philosophical and non-confessional organizations within the Union.

The first two paragraphs of article 17 require the European Union (hereinafter EU) to respect and not to prejudice the status of churches and religious associations or communities, as well as relevant philosophical and non-confessional organizations that are recognized by its member States, under their respective jurisdictions. Meanwhile, the last paragraph of this article highlights the recognition in the Union of the identity of, and the specific contribution made by churches and religious associations or communities, and of philosophical and non-confessional organizations, with which the EU "will maintain an open, transparent and regular dialogue". These provisions have been interpreted during the process of drafting of the rejected Treaty establishing a Constitution for Europe¹ by numerous persons as "threatening" the principle of separation between Church and State, excluding the principle of secularism that characterizes all current EU Member States.

It is, as we shall see, one of the issues about which more debate has been aroused in recent years when it comes to the reform of the original Community Law. This has, at the same time, highlighted the important differences that exist in the 27 EU Member States with

respect to the issue of religion. What was being questioned was not religious freedom, but rather the legal position that churches and philosophical and non-confessional organizations should occupy within the Union. Nowadays nobody doubts religious freedom is a fundamental right for all human beings, which is supported by art. 9 of the European Convention on Human Rights (hereinafter ECHR)² and, moreover, this is reflected in the abundant writing which exists on the topic.³ On the other hand, the novel nature of article 17 of the TFEU and the fact that it has not, as yet, come into force, might well explain the existence of so few commentaries within specialist legal writings.

With the intention of showing the path taken by churches and philosophical and non-confessional organizations up until their current situation of recognition within the framework of the EU, this study will be divided into two parts. In the first part, we will analyse the legal position of both churches and religious associations or communities, as well as that of philosophical and non-confessional organizations before the signing of the Lisbon Reform Treaty, with particular attention to activities carried out under the European Convention (I), and, in the second part, try to present the scope and content of article 17 of the TFEU which, as we have mentioned above, consists of the official recognition by the Union of churches and the philosophical and non-confessional organizations (II).

Literature review:

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I. The legal position of churches and philosophical and non-confessional organizations within the European Union before the signing of the Treaty on the Functioning of the European Union

It should be stressed from the outset that the original Treaties of the European Communities did not make any reference to the fundamental rights of human beings in general, and the freedom of religion or religions existing in the Member States in particular. It was not until the Maastricht Treaty that it was recognized that "the Union shall respect

fundamental rights as guaranteed in the European Convention on Human Rights and Fundamental Freedoms of November 4, 1950, and those which result from the constitutional traditions common to the Member States as general principles of Community law "(article F.2 TEU).

In the following years, and especially during the Intergovernmental Conference (hereinafter IGC) held in 1996, the Foreign Ministers of the fifteen Member States of the EU discussed what would be the best way to protect the rights and fundamental freedoms within the new European Community Treaty (hereinafter the EC Treaty). For example, the German delegation proposed the introduction of the following article on the legal status of Churches: "The Union considers that the constitutional position of religious communities in the Member States is both an expression of the identity of the Member States and their culture, as part of their common cultural heritage."

With respect to this, it is worthwhile to note the response of the then President of the European Commission, Mr. Santer, to a written question by a member of the European People's Party on this proposal. Mr. Santer said he felt that the proposal was part of the wider scope of protection of freedoms and fundamental rights of European citizens, and also noted that the IGC, which had been responsible for reforming the Maastricht Treaty, had considered the possibility that the EU joined the ECHR. He also emphasized the scope and content of article 9.1 of the ECHR, which stipulates that "everyone has the right to freedom of thought, conscience and religion".⁴ Lastly, noting that the German proposal was not a unique option, given that it had also been supported by the delegations of other States in the CIG'96. This proposal was also supported by the Vatican, which wanted the Church, in general, and the Catholic Church, in particular, to receive specific legal recognition within the foundational Community Law.

Finally, there was no update of article F.2 of the TEU which, after the reform of Amsterdam, became article 6.2 of the TEU, but rather it was decided to draw up a Declaration on the status of churches and non-confessional organizations, which was to be inserted as an appendix in the final Act of this IGC. At this point Greece considered necessary to recall the Joint Declaration regarding Mount Athos, which had been included as an appendix to the Final Act of the Treaty on its accession to the European Communities.⁵

Thus, the Declaration No. 11 was issued as an appendix to the Final Act of the EC Treaty signed in Amsterdam, under the title "Status of churches and non-confessional organisations", foresaw that "The European Union respects and will not prejudge the status under national law, of churches and religious associations or communities within the Member States. The European Union also respects the status of philosophical and non-confessional organizations".⁶

With relation to this point, it should be noted that this Declaration has no binding legal value for the EU or its Member States, being merely a political statement. Nobody, however, can fail to detect the recognition, which those who had drawn up the reform of the Maastricht Treaty were giving, especially to the Church, within the EU framework and, hence, the legal significance it holds within the Union. In addition, as this was a statement made jointly by the Heads of State and Government of all Member States, Declaration No. 11 is a general rule of interpretation according to Article 31 of the Vienna Convention on the Law of Treaties passed in 1969. Hence, it is an integral part of EU law and can therefore be invoked before the Court of Justice of the European Communities (hereinafter ECJ).

It is also worthy of mention that this was the first time in which a specific and explicit reference to religion was made, and also that the presence of churches and religious communities within the life of the EU was being recognised. For years an ongoing informal dialogue had been taking place between churches and faith-based and non-confessional organizations, on the one hand, and EU institutions, on the other.⁷ This dialogue went back to

the year 1963 when the Jesuits established an office in Brussels. These were followed ten years later by the Protestants and, in 1980, by the Committee of Bishops in the European Community (COMECE) and the Ecumenical Commission for the Church, which in 1999 became the Church and Society Commission of the Conference of European Churches (CEC). Also, the Vatican appointed in 1999 an apostolic nuncio to the EC. Among the demands made by these interlocutors of the European Commission were the following: the existence of a pre-legislative consultation process, regular working sessions to be organized on matters which might prove relevant to the Church, occasional work meetings, and a liaison "bureau" to be included within the main seat of the Commission.⁸

With respect to the contributions made by the Community Institutions to this dialogue, it must be mentioned that in 1989, the then President of the EU, Mr. Delors, decided to create a Forward Studies Unit which was to work as a service under his authority which would have control, among other things, over the carrying out of reports on various issues which would later form part of the working agenda of the Commission itself. Among the achievements of this Forward Studies Unit, it is worth mentioning the various meetings held in order to contribute to an inter-religious dialogue within the Community, and which may have inspired Mr. Delors to propose in 1992 the project entitled "A soul for Europe: Ethics and spirituality" which would serve as a point of support for European construction and integration.⁹

On the other hand, Mr. Romano Prodi, during his term as President of the European Commission, changed the Forward Studies Unit into the Group of Political Advisers to the President (GOPA), made up of various diplomats, and whose main activity consisted of regulating the relationships between the different Churches and the EU Institutions.¹⁰

Among the precedents of article 17 of the TFUE there can be found certain documents from the Community Institutions, which discuss religious matters within the framework of the EU, and a number of sentences from the ECJ referring to various aspects of religion.

Thus, the European Commission, in its White Paper on European Government, recognised the special contribution made by churches and religious communities, as an integral part of civil society, to allow European citizens to "express their concerns and offer services which respond to the needs of the population".¹¹ The Council also adopted a number of Resolutions on this subject. The first of these was the Directive 89/552/CEE on television broadcasting.¹² Article 11.5 of this contains the prohibition of placing advertising during the broadcast of religious services of less than 30 minutes duration, and article 12.c) states that TV advertising must not "go against religious convictions". The Directive 2000/78/CE, however, relativizes the importance of establishing a general framework for equal treatment in employment and occupation, and is, thus far, the most important ruling in secondary legislation.¹³ As regards the topic at hand, besides the principle of non-discrimination on the grounds of religion, belief, disability, age or sexual orientation in employment and occupation (Article 1), this Directive states that Member States have complete freedom to maintain or adopt whatsoever national legislation they deem appropriate, including the justification of differential treatment on the grounds of religion or the belief that it may be necessary to respect the ethics of the organization, "acting in accordance with national constitutional and legal proceedings", with the ability to require, furthermore, "of the people working for them to act in good faith and loyalty to the organisation's ethos "(article 4.2).

The European Parliament also adopted two reports quite recently on the role of religion in certain EU policies. Reports which emphasized, among other features, the negative aspects of "the interference of churches and religious communities in public and political life" of the Member States.¹⁴ This was interpreted by doctrine as an intrusion of this EU institution within the internal affairs of its Member States, directly affecting the cultural and religious traditions of their nationals.¹⁵ Even so, in our opinion, these Parliamentary documents have provided a

breakthrough in the path taken by churches and religious associations or communities towards the official recognition that was given in Lisbon in 2007.

As such it is worth mentioning that the absence of an express provision in the founding Treaties on the issue of religion has not prevented the ECJ from taking into account the fundamental right of religious freedom contained in article 9 of the ECHR. The Praetorium from Luxembourg has estimated that this law is fully protected by Community law for the time being, given that all EU Member States ratified the Convention. The first judgement of the ECJ in this regard has been delivered in the case of *Prais/Council*, of October 27, 1976.¹⁶ This judgement was followed by others, especially with regards to the free movement of people¹⁷, and the free movement of services, and social security for migrant workers¹⁸. Suffice to say that now, the *Udo Steymann* case of October 5, 1988, in which the Court ruled that that economic activities are any activities carried out by members of a community based on religion or any other spiritual or philosophical inspiration within the framework of the commercial activities of this community, to the extent that the services performed by the community in favour of its members may be regarded as indirect compensation for real and effective activities.¹⁹

In our view, the real turning point with respect to the introduction of a whole article devoted to the legal status of churches and philosophical and non-confessional organizations in original Community law has been fruit of the work undertaken within the framework of the European Convention. In this connection, one might recall that at the European Council at Laeken in December 2001, the Heads of State and Government of Member States agreed to convene a European Convention to prepare a future IGC to be made responsible for the reform of the Treaties that had established the European Communities and the EU.

The study of issues concerning the status of churches and non-confessional organizations, developed under the European Convention was prepared in various contact groups in civil society, as well as various plenary sessions devoted to civil society which took into account the contributions of organizations represented in the Forum established by the Laeken Declaration to provide greater transparency to the public of the work undertaken by the European Convention. With this in mind, it should be noted the large number of petitions that were submitted to this Convention by various religious organizations existing in the EU. In these petitions it was requested that the future Project for a European Constitution should “contain a spiritual element, with an explicit recognition of the religious and spiritual heritage of Europe” or that it should contain the Declaration No. 11 on the respect for the status of churches.²⁰

Furthermore, on June 12, 2002 a meeting of the Contact Group with various organizations from civil society working in the field of culture was held in Brussels under the chairmanship of Mr. Meterle. Among the selected topics to be discussed on that occasion was that of churches and religious associations. Many of the participants interested in this subject showed their commitment to Declaration No. 11, which was an appendix to the Amsterdam Treaty. As it was felt that the values of the European continent, such as peace, freedom, dignity, solidarity and democracy, were in debt to the religious heritage of Europe, and especially Christianity, this should not be forgotten and should thus be enshrined in European texts. On the other hand, one participant in the meeting said quite the opposite - that an increasingly significant proportion of the population of the EU no longer feels related to this religious heritage, “and that any mention of it would lead to the introduction of divisions between believers and non-believers” among European citizens.²¹

The possible inclusion in the draft European Constitution of a separate article referring to the status of churches and non-confessional organizations was undoubtedly one of the most widely discussed topics during the European Convention. Proof of this could be seen in the large number of amendments that were received by the Secretary of the European

Convention. Thus, many people sought to delete this article in its entirety, or requested that it should include some reference to a specific religion or belief. Because, it was believed, otherwise it would not be possible to guarantee religious freedom, the change of religion, the expression of religion through worship and religious association. This is also contrary to the principle of the secular nature of the state and of the separation of and independence between the State and the Church. Along these lines can be seen the contribution which Mr Borrell (member of the European Convention) and Mrs. Carnero and Lopez Garrido (alternate members of the European Convention), filed with the Secretary General of the European Convention on “Respect for the principles of the freedom of religion and the secular nature of the state” which was eventually signed by 163 members of the European Parliament, from seven different political parties.²²

Finally, the Declaration No. 11 became the first two paragraphs of Article I-51 of the Draft Treaty on establishing a Constitution for Europe.²³ Later a third paragraph was added to the article on the status of churches and non-confessional organizations.

This is an article that has been widely discussed and debated. Specifically, the amendments to the first two paragraphs, among other things it was requested: to add the word “faith” in the title thereof, or to delete the words “philosophical” in the first paragraph, or to clarify that the statute for schools was also to be included in the first paragraph in order to guarantee in this way that freedom of recruitment of teachers according to religious criteria could not be considered to be discriminatory, or that it should not attack the integrity of the human being, with a view to combating sects, or requests for the inclusion not only of the “status” but also of the “activities” of churches, religious associations or communities, as well as the philosophical and non-confessional organizations within the contents of this item.²⁴

With respect to the third paragraph of article I-51 of the Draft Treaty on establishing a Constitution for Europe, most of the amendments received asked the European Convention to delete this paragraph. On the other hand, those who were in favour of its introduction into the final text of the draft European Constitution suggested, among other things: that dialogue with churches and non-confessional organizations should not lead to the granting by the EU of “financing” in order to facilitate such a dialogue; limit its scope only to the churches as non-confessional organizations were included under the provisions of the article which referred to the principle of participatory democracy; ensure that the dialogue should not only be “regular” but also “open and transparent”; clarify the fact that the dialogue with the churches is to be carried out while respecting the “profoundly secular character of the EU”. Some proposals were even made adding a first paragraph to the article on the status of churches and non-confessional organizations, to ensure religious freedom within the Community and even a new, separate article, which would deal with the same issues, but with regard to the regions and local collectives.²⁵

Despite the numerous requests that were made within the framework of the European Convention in the sense that this article on the status of churches and non-confessional organizations should not be included within the text of the draft European Constitution, the majority of the Delegates who spoke during the Plenary meeting held in Brussels on April 24 and 25, 2003 were in favour of it being maintained in the legal text. Meanwhile, others felt that the term “philosophical” was not really understood and suggested that it be replaced with “cultural”, or thought that the third paragraph should not include religious or non-confessional organizations which threaten the integrity of the human being or which do not respect values embodied in this project. Finally, one Delegate showed his concern about the legal consequences of this provision at a national level. It is, however, remarkable that, in general, many Delegates who spoke on these issues explicitly supported the inclusion of an article that related to the status of churches and non-confessional organizations. And all this took place

despite the doubts which some Delegates expressed in relation to the third paragraph on the organization of a structured dialogue.²⁶

Finally, the Praesidium of the European Convention adopted a defensive and prudent stance, deciding not to modify the content of Declaration No. 11, which was an appendix to the Amsterdam Treaty, and just proceeded to lighten the text. The Praesidium felt that if it ventured to rewrite this text, it would risk reopening a more debate which would turn out to be more general and more difficult, than the one that had previously been held.²⁷

As regards the contribution of CIG'2003 respecting the article dealing with the status of churches and non-confessional organizations, it is worth noting that only Belgium in recent discussions, in December 2003, opposed any mention of religion and formally proposed the suspension of this article. This initiative ultimately failed.²⁸ Moreover, from a formal point of view, article I-51 became article I-52 in the Treaty establishing a Constitution for Europe.

II. The range and contents of article 17 of Treaty on the Functioning of the European Union

a) Article 17.1 and 2 of the Treaty on the Functioning of the European Union:

As we have mentioned, the first two paragraphs of Article 17 of the TFEU reflect in its entirety the Declaration No. 11, which had been included as an appendix to the Treaty signed in Amsterdam. Thus, this Declaration has a greater significance as it is included in the original articles of Community Law. The CIG'2007 which was responsible for the reform of the Treaties establishing the European Community and the EU after the rejection of the European Constitution in the Netherlands and France²⁹ maintained in full the old article I-52, which went on to become now article 17.

For the first time the role of religions and the philosophical and non-confessional organizations in the EU were explicitly recognised. In this connection, it should be stressed that, unlike the text of the European Constitution which situated article I-52 along with other provisions relating to the democratic life of the Union (namely the principle of democratic equality, the principle of representative democracy, the principle of participatory democracy, etc.)³⁰, only this article on the status of churches and non-confessional organisations became part of the TFEU, while the other articles in question are mentioned in the new EU Treaty. But this fact should not be interpreted in any way as diminishing the relevance of any explicit recognition that the EU makes regarding the role of churches and non-confessional organisations within the Union.

Article 17.1 and 2 of the TFEU, by establishing that the EU must respect the status of churches and religious associations or communities which has been recognized under the national law of each Member State, means that the States of the Union can have whatever religion they want. And, hence, the EU cannot fix a common EU-wide model of relationships which its Member States must maintain with churches, religious associations or communities, and with the philosophical and non-confessional organizations in their territories.

Ultimately, therefore, the Union is, in respect to these organisations, in a neutral position.³¹ Thus it is the Member States who have to choose the system of their relationships with churches, confessions and philosophical and non-confessional organizations that coexist in their territories, in accordance with their respective domestic legal systems³², and fully respecting the principle of subsidiary relations. In accordance, therefore, with article 5.3 of the new EU Treaty, “in areas which do not fall within its exclusive competence, the Union will intervene only if, and to the extent that the objectives of the proposed action cannot be sufficiently achieved by Member States whether at a central level or at regional and local

levels, but which could be better achieved due to the scale and impact of the proposed action, at an EU level”.

What has been interpreted by some in the sense that religious freedom is compatible with the confessional state or with the secular state. Equal rights of freedom of religious beliefs and ideologies for European citizens appear to be guaranteed, as any discrimination based on religion is prohibited.³³ From our point of view, this is in line with the policy that has been maintained by the EU since the beginning of its existence.

In this context, we find it to be of the utmost importance that in all 27 Member States there should be an adequate legal framework for the recognition of religious institutions and philosophical and non-confessional organizations within its territory. Unfortunately, many EU States do not have, at present, a registration system for religious bodies that has been drawn up in accordance with its domestic legal system. This means that the average citizen is threatened by the danger that certain entities could put their life, or their physical and mental integrity, in jeopardy. Without doubt, the establishment of the limits of freedom of association for religious communities is not a peaceful issue. This has also become clear in light of the judgement of the European Court of Human Rights of April 5, 2007, pronounced in the case of the *Church of Scientology of Moscow v. Russia*.³⁴

A reading of article 17.1 and 2 also reveals that the EU has no competence in this area. This is also apparent in articles 3, 4 and 6 of the TFEU, in which there is no reference to be found about any possible power held by the Union on these issues. In addition, in order to assure that the EU “respects and does not prejudice the status in its Member States” of churches and philosophical and non-confessional organizations, we believe that the Union has the obvious intention of remaining neutral with respect to all faiths and ideologies existing in its Member States, and as such this also constitutes an important step forward in terms of freedom of conscience.³⁵

It should also be noted that the reference to non-confessional organisations in article 17.2 can be interpreted as an attempt by the EU to soften possible reactions to such explicit recognition of the status of churches and religious associations or communities within the EU. Such a reference has been criticized by some of the more conservative sectors of the Catholic Church, who believe that they had been equated to “social clubs”. In our view, this provision of the TFEU represents the desire of the Union itself to institute the principle of equality between religions on the one hand and philosophical and non-confessional organizations, on the other. In this way, it echoes the position of the European Commission of Human Rights, which, in the case of the *Atheists Union v. France*, sanctioned a treatment which it considered to be discriminatory between religious and non-religious associations which pursue the same objective, that is, the defending of convictions.³⁶

Lastly, it should be noted that article 17.1 and 2 of the TFEU, which mentions the recognition of the domestic law of the Member States regarding the status of churches and organizations of philosophical and non-confessional organizations, should not be confused with certain provisions of the Charter of Fundamental Rights of the EU³⁷ now that this has become part of original Community Law, by means of reference³⁸, under Art. 6.1 of the new EU Treaty which stipulates that “The Union recognises the rights, freedoms and principles set forth in the Charter of Fundamental Rights of the European Union [...], which will have the same legal value as the Treaties”.

These are, firstly, Article 10.1 of the Charter which recognizes freedom of thought, conscience and religion – “Everyone has the right to freedom of thought, conscience and religion. This right includes freedom to change religion or belief and freedom to manifest one's religion or belief individually or collectively, in public or private, through worship, teaching, practice and observance of rituals”. The great difference between article 17.1 and 2 of the TFEU and article 10.1 of the Charter is the fact that the first one refers only to the

status of the organizations listed above³⁹, while the latter deals with the situation and the rights of individuals with regard to religion or their beliefs, so that the practical application of article 22 of the Charter is that concerning the respect for “cultural diversity, religious and linguistic diversity”.

From our point of view, it would be ridiculous to think that the EU has now renounced the secular identity now that article 17 of the TFEU reflects the status of churches and religious associations or communities. Nor should we forget that article 14.3 of the Charter of Fundamental Rights of the EU provides for the freedom of the establishment of schools within “while respecting democratic principles and the right of parents to ensure education and teaching their children according to their religious philosophical and pedagogical beliefs”.

Finally, it should be noted that, when the Charter of Fundamental Rights of the EU reaches the same legal value as the new TEU and TFEU, the involvement of churches and non-confessional organizations in the democratic life of the Union is strengthened and at the same time, it also reaffirms the secular nature which exists within the EU. In our view, the Union remains a diverse and pluralistic space in terms of cultural and ideology, representing a secular space, within which Christians, Jews and Muslims, among others, have long lived together, and in a peaceful manner for decades.

b) Article 17.3 of the Treaty on the Functioning of the European Union:

Undoubtedly, article 17.3 of the TFEU represents the greatest innovation for the subject matter of this essay, institutionalizing an “open, transparent and regular dialogue” between churches and non-confessional organizations with the Union itself. This is a dialogue that had already existed, but on an informal basis until now.⁴⁰ In our view, this provision is part of the efforts made by the EU for a greater democratization of its activities. Such efforts have also been patents as a result of article 10 of the new EU Treaty which reflects the principle of representative democracy, and Article 11 of the new EU Treaty referring to the principle of participatory democracy.

As such, this section provides the conviction held by the Union itself that churches and philosophical and non-confessional organizations can have a positive role in contemporary society.

But who are the interlocutors of the EU institutions in this "open, transparent and regular" dialogue, which hitherto had been a mostly informal dialogue with the European Commission? These are mainly from: the Commission on Bishops in the European Community (COMECE), the Church and Society Commission of the Conference of European Churches (CEC), the Bureau of the Orthodox Church to the European Union, the Conference of European Rabbis, the Muslim Council of Cooperation in Europe (CMCE), the European Humanist Federation, the European Evangelical Alliance (EEA), the World Conference on Religion and Peace, and the Spiritual and Socio-Cultural Spaces within European Society.⁴¹ In other words, these would include representatives of the Catholic Church, of Protestantism, of the Orthodox Churches, of Judaism, of Islam, and of various non-confessional organizations.

At the same time, it must be noted that the repeated mention of the word “respect” implies certain positive obligations for the Union in favour of the members of European civil society, mentioned in article 17, because, as the European Court of Human Rights has stated, “respect [...] means more than (recognizing) or (taking into consideration): In addition to a compromise which is above all negative, this verb implies a certain positive obligation on the part of the State”.⁴²

It is therefore an additional paragraph referring to "open, transparent and regular" dialogue that the EU institutions are bound to keep with the said churches and organizations also referred to in Article 11.2 of the new EU Treaty. It is this same article that has led many to think that it would be excessive to incorporate article 17.3 of the TFEU as this was considered to be redundant. What we cannot get away from is the fact that Union has wanted to give the Church and those organizations a more prominent power than that granted to the rest of civil society.

CONCLUSION

Throughout this essay, we have focused on the analysis of the scope and content of article 17 of the TFEU on the status of churches and non-confessional organizations, which also institutionalizes an "open, transparent and regular" dialogue with these community institutions.

This is undoubtedly a great advance that has contributed to the founding Treaties, one which helps reduce, in our view, the traditional democratic deficit of the Union. It is an advance that also falls within the process of rapprochement of European citizens to EU institutions, which could clarify within this area, the position of the EU. Undoubtedly article 17 of the TFEU represents a step forward in this area, but it really should go somewhat deeper.

In the first part of our study, we have had an opportunity to review the most important moments related to the legal position of churches and non-confessional organizations within the EU. Thus, we have analysed the emergence and consolidation of a dialogue, at first informal and later of an institutionalized nature, of these organizations with the Union itself. In this regard, we have paid particular attention to the work of the drafting of the text of a Treaty through which there could be established a Constitution for Europe.

In the second part, we have focused on the study of the said article itself. The first two paragraphs set out and give greater scope to legal Declaration No. 11, an appendix to the Treaty of Amsterdam, under which the Union respects and does not prejudice the status of churches and philosophical and non-confessional organizations, recognized as such by Member States according to their relevant national laws. But this lack of EU powers in the religious sphere should not be interpreted as a possible lack of action by the Church in the everyday life of the Union since, under the principle of participatory democracy; it institutionalizes a possible right of the Church to interfere in the EU institutions. In such a way it culminates the requests constantly formulated by the Vatican since the CIG'96 and which have continued to be made up until the present. In our view, it is obvious that through article 17 of the TFEU the way is open for the Church to intervene, directly in the Union's policies on many matters concerning the life of European citizens, and especially on issues that are of particular interest to the Church, such as: abortion, euthanasia, family planning, religious education, etc.

However, we believe that this situation represents, at the same time, a possibility for the EU to control these and not only to favour them.

The article of the Treaty Reform which has been subject of our attention in this paper ends with a reference to an "open, transparent and regular" dialogue which the EU is committed to keeping up with churches and non-confessional organizations, which gives them a prominent place within the broader dialogue that it seeks to develop with the various participants of civil society.

One might conclude by stating that the controversy which has been generated in recent years over the religious factor has highlighted the need for the opening of a debate between the Union and various religious and philosophical and non-confessional organizations, to be characterized, we believe, by a spirit of tolerance in line with a multiethnic and multicultural society such as that which exists within the EU at the present time.

End Notes

¹ Treaty establishing a Constitution for Europe, *OJ C* 310, 16.12.2004, pp. 1-474.

² Art. 9 ECHR establishes that: “1. Everyone has the right to freedom of thought, conscience and religion; this right includes freedom to change his religion or belief, and freedom, either alone or in community with others and in public or private, to manifest his religion or belief, in worship, teaching, practice and observance. 2. Freedom to manifest one's religion or beliefs shall be subject only to such limitations as are prescribed by law and are necessary in a democratic society in the interests of public safety, for the protection of public order, health or morals, or the protection of the rights and freedoms of others”.

³ For this, see: J. A. Frowein, “Article 9.1”, in *La Convention Européenne des Droits de l'Homme. Commentaire article par article*, dir. by Louis-Edmond Pettiti, Emmanuel Decaux and Pierre-Henri Imbert (Paris : Economica, 1995), 353-360; María Encarna García Jiménez, *El Convenio Europeo de Derechos Humanos en el umbral del Siglo XXI* (Valencia: Tirant lo Blanch, 1998); Alejandro Torres Gutiérrez, “La libertad de pensamiento, conciencia y religión (Art. 9 CEDH)”, in *La Europa de los Derechos. El Convenio Europeo de Derechos Humanos*, coord. Javier García Roca and Pablo Santolaya (Madrid: Centro de Estudios Políticos y Constitucionales, 2005), 509-527.

⁴ Written Question No. 1121/97, by Bartho Pronk to the Commission. German proposal to include a “churches clause” in the revised Maastricht Treaty, *OJ C* 319, 18.10.1997, p. 232.

⁵ Treaty of Amsterdam amending the Treaty on European Union, the Treaties establishing the European Communities and certain related acts – Declarations of which the Conference took note – Declaration by Greece concerning the Declaration on the status of churches and non-confessional organisations, *OJ C* 340, 10.11.1997, p. 144. This Declaration says: “With reference to the Declaration on the status of churches and non-confessional organizations, Greece recalls the Joint Declaration on Mount Athos annexed to the Final Act of the Treaty of Accession of Greece to the European Communities”.

⁶ *OJ C* 314, 10.11.1997.

⁷ For this, see: Bérengère Massignon, “Les relations entre les institutions religieuses et l'Union européenne: un laboratoire de gestion de la pluralité religieuse et philosophique?”, in *Les mutations contemporaines du religieux*, ed. Armogathe and Willaime (Brepols: Turnhout, 2003), 25-43.

⁸ In this case, see: COMECE/KEK, June 2002.

⁹ For this, see: Massignon, “Les relations entre les institutions religieuses et l'Union européenne: un laboratoire de gestion de la pluralité religieuse et philosophique?”, 29.

¹⁰ See: Pierre de Charentenay, “Les relations entre l'Union européenne et les religions”, *Revue du Marché commun et de l'Union européenne* 465 (2003): 94; Bérengère Massignon, “Les relations entre les institutions religieuses et l'Union européenne : un laboratoire de gestion de la pluralité religieuse et philosophique?”, in *Les mutations contemporaines du religieux*, ed. Armogathe and Willaime (Brepols: Turnhout, 2003), 29-30.

¹¹ COM(2001) 428 final: European Governance – A White Paper, *OJ C* 287, 12.10.2001, p. 16.

¹² Council Directive 89/552/EEC, of 3 October 1989, on the coordination of certain provisions laid down by Law, Regulation or Administrative Action in Member States concerning the pursuit of television broadcasting activities, *OJ L* 298, 17.10.1989, pp. 23-30.

¹³ Council Directive 2000/78/EC, of 27 November 2000, establishing a general framework for equal treatment in employment and occupation, *OJ L* 303, 2.12.2000, pp. 16-22.

¹⁴ This is specifically: European Parliament resolution on women and fundamentalism, P5_TA (2002)0110, adopted 13.03.2002; *OJ C* 47 E, 27.02.2003, p. 406; European Parliament resolution on sexual and reproductive health and rights, P5_TA (2002)0359, adopted 3.07.2002; *OJ C* 271 E, 12.11.2003, p. 369.

¹⁵ In this case, see: Charentenay, “Les relations entre l'Union européenne et les religions”, 95-96.

¹⁶ Case 130/75, *Prais/Council*, [1976] ECR, p. 1589.

¹⁷ This deals with matters which were brought up, for example, the Luxembourg Tribunal with reference to the recognition of higher education qualifications of people who, because of their work in educational institutions depending on the Church (see: Case C-102/02, *Beuttenmüller*, [2004] ECR, p. I-5405); income tax for EU citizens carrying out practical work for the Church (see: Case C-169/03, *Wallentin*, [2004] ECR, p. I-6443), etc.

¹⁸ Case 300/84, *van Rosmalen*, [1986] ECR, p. 3097.

¹⁹ Case 196/87, *Udo Steymann/Staatssecretaris van Justitie*, [1988] ECR, p. 6159, point 14.

²⁰ European Convention: “Digest of contributions to the Forum”, CONV 112/02, 17.06.2002, p. 8.

²¹ European Convention: “Contact groups (Civil Society)”, CONV 120/02, 19.06. 2002, AnnexVIII.

²² European Convention: "Respect for the principles of freedom of religion and laicism of the State", CONV 587/03, 26.02.2003.

²³ Draft Treaty establishing a Constitution for Europe, *OJ C* 169, 18.07.2003, pp. 1-105.

²⁴ European Convention: "Summary sheet of the proposals for amendments relating to the democratic life of the Union: Draft articles for Part One of the Constitution, Title VI", CONV 670/03, 15.04. 2003, pp. 24-25.

²⁵ *Ibidem*, p. 25.

²⁶ European Convention: "Summary Report of the Plenary Session - Brussels, 24 and 25 April 2003", CONV 696/03, 30.04.2003, pp. 6-8.

²⁷ European Convention: "Draft Constitution, Volume I. Revised text of Part One", CONV 724/03, 24.05.2003, p. 118.

²⁸ COMECE: *Lettre Circulaire*, Bruxelles, 9.12. 2003.

²⁹ For an ample study of the process of ratification of the Treaty for the Establishment of a Constitution for Europe within the Member States, as well as the candidate countries for membership of the EU, see: Anneli Albi and Jacques Ziller, eds., *The European Constitution and National Constitutions: Ratification and Beyond* (The Netherlands: Kluwer Law International, 2007).

³⁰ This is specifically: articles I-45 to I-52 of the European Constitution. See: Patrice Rolland, "Article I-52", in *Traité établissant une Constitution pour l'Europe. Commentaire article par article. Parties I et IV "Architecture constitutionnelle"*, Tome 1, dir. Laurence Burgorgue-Larsen, Anne Levade and Fabrice Picod (Bruxelles: Bruylant, 2007), 674-676.

³¹ In this case, see: Massignon, "Les relations entre les institutions religieuses et l'Union européenne : un laboratoire de gestion de la pluralité religieuse et philosophique?", 30-32; Torres Gutiérrez, "La libertad de pensamiento, conciencia y religión (Art. 9 CEDH)", 510-512.

³² It is considered that nowadays there are three different types of relationships between State and Church in the EU Member States: firstly, the system in which there is a Church of State; secondly, the system characterized by a strictly separation between State and Church; and, thirdly, the system where there is an idea of the Church separated from the State, but that allows to the Church to have social and legal privileges. For this, see: Gerhard Robbers, *State and Church in the European Union*, 2nd ed. (Nomos, Baden-Baden, 2005); Louis-Léon Christians, "Droit et religion dans le Traité d'Amsterdam: une étape décisive?", in *Le Traité d'Amsterdam. Espoirs et déceptions*, coord. Yves Lejeune (Bruxelles: Bruylant, 1998), 206-209.

³³ See: Ana Fernández-Coronado González, "La influencia de la religión en la configuración del Derecho de la Unión Europea", *Revista de Ciencias de las Religiones* XI (2004): 37.

³⁴ Case 18147/02, *Church of Scientology Moscow v. Russia*, 5.04.2007. See: José Daniel Pelayo Olmedo, "La legitimidad o ilegitimidad de la intervención administrativa en la formación de las comunidades religiosas. Comentario a la Sentencia del Tribunal Europeo de Derechos Humanos de 5 de abril de 2007, asunto Iglesia de Scientology c. Rusia (demanda nº 18147/02)", *Revista General de Derecho Europeo* 14 (2007): 1-21.

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³⁷ Charter of Fundamental Rights of the European Union, *OJ C* 364, 18.12.2000, pp. 1-22.

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⁴¹ Esther Souto Galván, "El estatuto de las iglesias y de las organizaciones no confesionales", in *Libro II. Los derechos y libertades*, dir. Enrique Álvarez Conde and Vicente Garrido Mayol (Valencia: Tirant lo Blanch, 2004), 372-376.

⁴² Case 7511/76 and 7743/76, *Campbell and Cosans v. United Kingdom*, 22.03.1983, point 37.

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EXTERNAL DEBTS SUSTAINABILITY, IMF POLICIES EFFECT AND TURKEY SAMPLE

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Abstract

It is generally recognized that developing countries need substantial amounts of net transfer of resources at early stages of development in order to close their savings and foreign exchange gaps. External³ borrowing is a core element in nearly all developing countries' development strategies. Foreign loans can be used to finance public spending aimed at increasing growth, development, and security. Debt sustainability and holding the debt burden at a reasonable level are the two main cornerstones of achieving macroeconomic stability. Solvency is derived from the intertemporal budget constraint which shows sustainability of current policies. Generally, when the expected value of the future resources devoted to debt service equals the current debt stock, solvency condition is satisfied. Developing countries' debt is external debt incurred by Third World countries, generally in quantities beyond that country's ability to repay. Unpayable debt is a term used to describe external debt where the interest on the debt exceeds the amount that the country produces, thus preventing the debt ever being repaid.

IMF' policies through to the World Economy have been changed in the globalization processes. Those policies have been applied in different countries When Turkish economy is taken into consideration it is seen that; it has high debt stocks, the need of external debt continues to increase and the external debt indicators give rise to the anxieties about the issue of external debt sustainability. This paper responds to take forward on external debt-related vulnerabilities and balance sheet risks.

Key words: External debt, IMF policies, debt sustainability, debt burden, Turkey debt

1. INTRODUCTION

Throughout their history developing countries have been subject to repeated economic crises, with serious consequences for their long-term growth prospects. The links of these crises to the external sector performance, including the problems of external debt and its sustainability, have been the subject of prolonged debate. While the issue of debt was always present, particularly in relation to the increased availability of investable resources, the relevance of this topic has been heightened in recent years. Increasing capital mobility and greater use of market borrowing by emerging economies may well have helped to improve economic performance and growth prospects, but with low levels of bilateral and multilateral lending the vulnerability of the developing countries' economies has increased.

As developing countries became more integrated into the world economy and a wider universe of private investors have come into the picture, the volatility of capital flows has risen sharply and aggravated the effects of both internal and external shocks. More dramatically, developing countries have seen their debt burden remain high as a proportion of

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³ is defined as the total public and private debt owed to nonresidents repayable in foreign currency, goods, or services(IMF define, external financing to borrowing in foreign currency from nonresident creditors.)

GDP with the possible exception of East Asia; and their rate of growth has lagged behind that of the industrialized world, most dramatically in Latin America and Sub-Saharan Africa. The high debt burden, low growth rates, and considerable resource outflows has put in serious doubt the premise that foreign borrowing on current terms is an appropriate mechanism to enhance growth (Loser 2004). The amount of developing countries external debt in 2004 was 2.5 trillions of dollars, this amount represents 34 per cent of the Third World Gross National Product (GNP). Taking into account that in 1968 the Third World debt represented nearly 50 thousand millions dollars, the amount has increased by 50 times.(Choike 2008)

2. LITERATURE REVIEW

In some countries, debt places such a burden on the economy that it cannot correctly function. Some see this as an argument against maintaining such a debt. In this context, most heavily debated topic is sustainable deficit, keeping deficits at some acceptable level. In an incidence that current deficits exceed sustainable deficit, revising budgetary targets or undertaking alterations in fiscal policy is required. The theoretical literature emphasizes the intertemporal budget constraint as well as the flow-budget constraint of the government, and focuses on whether current fiscal policy can be continued into the distant future without threatening government solvency. Yet, at the level of empirical policy analysis, the term “fiscal sustainability” remains highly controversial, and each empirical study often develops its own definition of the concept and derive its conclusions accordingly. (Voyvoda and Yeldan 2005)

Theoretical discussions of external sustainability reference is often made to the trade balance as the key determinant of the evolution of the external debt ratio, in practice, the relevant variable is the primary current account balance, including current transfers and non-interest net income payments.

External sustainability refers to the ability of a country to meet the current and future external obligations of both private and public sectors without running into arrears, recourse to debt-rescheduling and eventually a -drastic balance-of-payments adjustment. In theory the conditions for external sustainability are analogous to those for fiscal sustainability. (Akyuz 2007). Although external debt provides additional source during the term they were acquired, it requires the transfer of a part of import income as principal and interest payment at the following terms. Moreover, since external debt is acquired in foreign currency, it poses serious impact on the balance of payments. During the period of repayments, the quantity of foreign exchange reserves plays a key role on the balance of foreign deficit. In economies that such balance could not be achieved, additional borrowing becomes necessary for debt-rescheduling. At such situations, domestic debt seems to be easier to reschedule since it usually is much easier to manage old domestic debt with new domestic debt acquired (Özkan 2006).

The rationale behind the creation of a domestic market for government securities in poor countries is that it could stimulate the development of deep and liquid internal financial markets and protect countries from adverse external shocks. When a country is heavily indebted, the prospect of a decline in net inflows, and a possible net resource outflow makes the management of the economy very demanding, as it transfers the cost of lower aid to the borrowing country, and hampers growth.

A rising external debt tends to weaken the economy. First, foreign borrowing increases vulnerability to external conditions. When debt is contracted at a floating rate, higher foreign interest rates lead to an increase in debt-servicing costs. This raises budgetary outlays, which may translate into a larger deficit or a reduction of nondebt outlays. Likewise, a depreciation

of the currency leads to increased debt servicing (in domestic currency terms), and has the same effects as those mentioned earlier. Second, when the government borrows to cover a growing deficit, foreign borrowing leads to an unsustainable level of debt, an excessive share of debt service in overall government expenditure, and substantial use of foreign exchange to service the debt. In the long run, this may lead to a debt crisis (Beaugrand et al. 2002). Moreover, the recent literature on debt intolerance emphasizes that developing countries historically have run into problems at much lower debt-to-output ratios than advanced countries. (IMF 2004)

Critics of the practical point in this argument question whether or not unpayable debt truly exists, since governments can refinance their debt via the IMF or World Bank, or come to a negotiated settlement with their creditors. However, this international debt problem has become such a crisis that many poor countries pay more money to the World Bank and the IMF each year than they receive in loans. The World Bank's own figures indicate that the IMF extracted a net US\$1 billion from Africa in 1997 and 1998 more than they loaned to the continent.

The problem has been greatly increased by the multilateral institutions' conditionalities, since the IMF determines the creditworthiness of countries: i.e., until the IMF gives its stamp of approval (which usually requires adherence to the economic policies it recommends), poor countries generally cannot get credit or capital from other sources. In the last few years, the World Bank and the IMF have agreed to help countries that are heavily suffering from major debt burdens by creating the Heavily Indebted Poor Countries (HIPC) Initiative of 1996. This facility seeks debt reduction by official creditors, including multilateral agencies, in the context of comprehensive programs of structural reform monitored by the IMF and the IBRD. However, even for the poor countries, the debt burden still remains high at some 50 percent of GDP and 180 percent of exports (Loser 2004). Even after qualifying for HIPC, a country must complete three years under an IMF-designed Structural Adjustment Program. Even after that hurdle, the country must fulfil a further three years bound by another SAP before relief is granted on its multilateral debt. The cruel paradox here is that the SAP requires them to cut spending on health care, food subsidies, and education.

3. EXTERNAL DEBT AND SUSTAINABILITY

3.1. SOURCES OF VULNERABILITY

This section covers the principles involving the sustainability of external debt, and the implications for debt management. External sustainability refers to the ability of a country to meet the current and future external obligations of both private and public sectors without running into arrears, recourse to debt-rescheduling and eventually a drastic balance-of-payments adjustment. In theory the conditions for external sustainability are analogous to those for fiscal sustainability (Akyuz 2007).

A common practice in evaluating debt sustainability is to focus on (gross or net) government debt as a share of the country's GDP. A sustainable government debt is one in which that debt ratio is stable or falling over time; a rising debt ratio denotes unsustainability. To determine what the debt ratio will be next year, the analyst makes (year ahead) projections for the economy's real growth rate, the real interest on the debt, and the noninterest component of the government budget expressed as a share of GDP (the so-called "primary surplus" or primary deficit).

Sustainability will depend among others on developments in the domestic economy and those related to the external environment, as well as the initial level and structure of external debt. The path to sustainability depends on a number of other conditions: the initial stock of debt, the availability of concessional financing, and the level of possible aid. This conclusion is important; while many countries have benefited from major debt reduction exercises, a country's success is still dependent on future availability of resources (Loser 2004). A domestic policy imbalance will have different implications depending on the nature of the external debt, e.g. whether it is market related or official, and whether it has a short- or long-term maturity structure, together with the overall conditions of the economy. While the long term effects of controls on outflows have been shown to have generally a negative impact, there may be short-term benefits at a time of a major crisis, like a bank run, or contagion. By its very nature, external debt sustainability entails the need to pursue a time-consistent path that will allow that the debt-servicing burden over time, as a minimum, does not hamper economic growth, and in more general circumstances enhances growth. (Loser2004).

For the external debt ratio to remain stable or to fall between two periods there should be an adequate amount of trade surplus; that is, a net transfer of resources abroad equal to the difference between net capital inflows and interest payments on external debt. The amount of surplus needed increases with the external debt ratio and the growth-adjusted real interest rate on external debt (Akyuz 2007).

Preventing a debt crisis is a crucial policy concern in a sustainable debt strategy. Ultimately, external debt crisis prevention hinges on one condition, that the debt payment capacity of debtor countries is fully supported by its export capacity. Unlike the primary budget balance the trade surplus needed is not directly linked to policy, but influenced by a host of variables operating on imports and exports, particularly the exchange rate and the rate of growth. (Akyuz 2007)

This brings us to the point that external debt has to be repaid in foreign exchange; hence trade plays a critical role. Exchange rate changes too can have asymmetric effects on fiscal and external sustainability. While a decline in the currency invariably makes it more difficult to maintain a stable public debt ratio, its effect on external sustainability can be benign. Although it increases the external debt ratio and the real interest rate, it also improves the current account by reducing imports and encouraging exports. These asymmetric effects imply that there can be a precarious link between external financial conditions and sovereign debt sustainability. A combination of lower international interest rates, increased appetites for emerging-market risks, surges in capital inflows and currency appreciations reduces the real effective interest rate and improves fiscal sustainability (Akyuz 2007).

However, whether foreign investors can increase competition and market efficiency, they can also bring risks, in terms of market volatility, since they could withdraw their investment if they have expectations of financial crisis, contagion, or deterioration of the macroeconomic framework (Arnone and Presbitero 2006).

3.2.THE ROLE OF DOMESTIC DEBT IN POOR COUNTRIES

Domestic debt, when well managed, can also reduce the government's exposure to interest rates and currency risks. However, domestic bond markets are expected to provide these possible benefits, only if some prerequisites are satisfied. In particular the World Bank and the IMF underline the importance of some key elements:

1. A stable macroeconomic environment;
2. An efficient money market

3. Broad investor participation;
4. The presence of a sound legal, regulatory and supervisory framework;
5. A non distortionary tax system;
6. An updated settlement infrastructure.

Domestic public debt is defined as the Central Government securitized debt: this is represented mainly by Treasury Bills, Bonds, notes and government stocks, even if in some countries there are other special securities and consolidated debt. For reasons of comparability across countries, the definition of domestic debt excludes loans, advances, local government debt and contingent liabilities – which are relevant in a number of countries – so that, in some cases, we are probably underestimating the real burden of domestic debt. (Arnone and Presbitero 2006).

The share of domestically issued public debt has risen, outpacing the rise in external debt in most regions. The growth of domestic debt markets reflects the success of many emerging economies in reducing inflation and deepening financial markets, though, as noted above, in several cases, the placement of large domestic bond issues for bank recapitalization in the wake of financial crises contributed as well (IMF 2004)

However, in developing countries, policy makers and international institutions have given to domestic debt far less attention than to external indebtedness. Even if the large concern on external imbalances is justified by a number of reasons and by the huge stocks of debt accumulated in the last decades, nonetheless a fully fledged macroeconomic analysis has to include domestic debt dynamics. In fact, domestic financing is becoming more and more important in many countries and there are reasons to believe that this trend will not revert, especially if donors' willingness to lend will decline over time. Such trend carries the probability of a domestic shock. Domestic policy shocks are likely to be the most sensitive source of vulnerability, most often resulting from inappropriate macro policies. The initial impact may be similar to those resulting from a real external shock, e.g. balance of payments pressures, inflation, and problems with economic activity. However, the mix between domestic adjustment and financing may well be different than when a country faces an external shock (Loser 2004).

3.3. EXTERNAL DEBT AMOUNT IN THE WORLD

The external debt still remains a heavy burden on underdeveloped economies and its regional distribution has changed in recent years. Various factors have had an influence on the new trends that can be observed regarding the total external debt accumulated by regions, among which the following are included: the financial instability of emerging markets, the deteriorated socio-economic situation in Africa, and the appeal of regions such as Eastern Europe, the Middle East and Asia for foreign investment.

According to International Monetary Fund figures from September 2006, the external debt amount of underdeveloped countries has remained unaltered around 2.1 trillion dollars.

By 2006, the regions were participating in the total debt amount in the following manner: Africa 7.7%; Asia 28.3%; the Middle East 7.8%; Eastern Europe 21.1%; the Community of Independent States 11.5%, and Latin America 23.6% (WEO, 2006).

According to estimates, underdeveloped countries paid 5.1 trillion dollars by way of debt service, that is, an annual average of 256 billion dollars, in the 1986-2006 period. (WEO, 2006).

Table 1. Other Emerging Market and Developing Countries: Ratio of External Debt to GDP 1

| Years | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|------|------|------|------|------|------|------|------|------|------|
| Other emerging markets and developing countries | 42.0 | 37.3 | 37.0 | 37.2 | 35.9 | 33.1 | 28.5 | 27.0 | 25.7 | 24.7 |
| <i>Regional groups</i> | | | | | | | | | | |
| Africa | 66.3 | 62.9 | 61.3 | 60.6 | 54.0 | 46.9 | 36.1 | 26.7 | 23.4 | 19.6 |
| Sub-Sahara | 70.2 | 67.4 | 66.6 | 65.8 | 58.4 | 51.0 | 39.2 | 28.9 | 24.9 | 20.3 |
| Central and eastern Europe | 47.7 | 50.0 | 52.5 | 52.3 | 53.2 | 53.3 | 49.4 | 55.7 | 51.8 | 52.1 |
| Commonwealth of Independent States | 75.1 | 56.4 | 45.8 | 43.1 | 41.8 | 36.2 | 33.4 | 32.5 | 33.4 | 31.8 |
| Developing Asia | 32.2 | 28.3 | 27.8 | 25.7 | 23.7 | 22.1 | 20.1 | 18.9 | 16.9 | 16.8 |
| Middle East | 32.6 | 28.2 | 27.4 | 28.0 | 27.0 | 26.3 | 23.4 | 25.3 | 26.0 | 25.1 |
| Western Hemisphere | 43.4 | 37.8 | 39.5 | 44.1 | 43.9 | 38.3 | 29.7 | 25.5 | 24.7 | 23.2 |

| Years | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| <i>Billions of U.S. dollars external debt</i> | | | | | | | | | | |
| Other emerging markets and developing countries | 2,454.4 | 2,372.6 | 2,388.6 | 2,460.9 | 2,687.8 | 2,931.5 | 3,013.3 | 3,342.4 | 3,762.7 | 4,118.0 |
| <i>Regional groups</i> | | | | | | | | | | |
| Africa | 291.4 | 283.2 | 275.0 | 288.7 | 312.5 | 328.3 | 295.4 | 245.6 | 243.5 | 255.6 |
| Central and eastern Europe | 277.0 | 299.5 | 305.1 | 353.5 | 441.7 | 539.8 | 588.5 | 745.6 | 843.6 | 929.9 |
| Commonwealth of Independent States | 218.8 | 200.6 | 189.4 | 199.5 | 239.4 | 280.9 | 335.1 | 420.2 | 534.0 | 610.5 |
| Developing Asia | 692.0 | 652.8 | 674.7 | 678.3 | 711.5 | 767.9 | 805.3 | 882.3 | 952.8 | 1,070.9 |
| Middle East | 182.5 | 177.0 | 173.2 | 178.0 | 192.1 | 217.0 | 237.7 | 299.8 | 354.0 | 387.6 |
| Western Hemisphere | 792.7 | 759.5 | 771.3 | 762.8 | 790.6 | 797.6 | 751.3 | 748.8 | 834.8 | 863 |

Source: IMF, World Economic Outlook, Globalization and Inequality, October 2007

3.4. SHORT-TERM EXTERNAL DEBT AND FOREIGN CURRENCIES

In the nonfinancial private sector, as elsewhere, domestic debt has been replacing external debt. The average external debt level across regions more than halved from 40 to less than 20 percent of GDP, falling markedly in all regions except in the Middle East, Africa, and Turkey group. At the same time, loans from the domestic banking sector rose from 30 to 45 percent of GDP, leaving the average overall debt level almost unchanged.

Because a high share of domestic debt is denominated in foreign currency, the sector's exposure to various market risks remains substantial. In 2001, the average amount of foreign-currency debt still amounted to over 30 percent of GDP—somewhat more than in 1994—of which only two-thirds constituted debt owed to nonresidents. This foreign-currency denominated domestic debt, which is the flipside of the rise in banks' foreign-currency loans described earlier, creates a vulnerability to currency risk among indebted households and firms (IMF 2004). Moreover, in the event of devaluation, holders of foreign-exchange linked debt may switch to foreign exchange denominated assets as they question the government's solvency. As the government services foreign-exchange-linked debt, it has to generate liquidity. In both cases, there will be pressures on reserves and/or the exchange rate. This type of debt is therefore included under foreign-currency debt (IMF 2004)

Dollarization implies that the banking system can be the source of large foreign-currency liquidity needs in a crisis. Banks that undertake maturity transformation in foreign currency—offsetting short-term funding from domestic dollar deposits with less liquid domestic dollar-denominated loans—are vulnerable both to a run and to the risk that exchange rate fluctuations will lead to a sharp deterioration in the quality of a bank's loan portfolio (credit risk). Large positions of liquid foreign-currency assets can increase the resilience of dollarized banking systems both because they may be a source of emergency liquidity.

Since commercial banks' own foreign exchange resources are often not sufficient, central banks have in many cases acted as lender of last resort—with moral hazard implications. This relates potential short-term foreign exchange claims (including deposits) to available liquidity buffers, including from the public sector's balance sheet. The build-up of official reserves has generally improved the ability to cover potential drains. Latin America is again the exception.

4. BALANCE SHEET DEVELOPMENTS IN RECENT FINANCIAL CRISES: SOME COUNTRY EXAMPLES AND IMF POLICIES

The IMF strategy for low-income countries requires more work in the following areas: (i) focus and flexibility—the Fund should focus on macrocritical issues tailored to individual country circumstances, broaden its division of labor with the World Bank, and offer more flexible lending facilities; (ii) aid and the MDGs—the Fund needs to assess whether projected aid flows are consistent with macroeconomic stability and the estimated costs of achieving countries' development goals, and also be more forthcoming with donors; and (iii) debt relief—the Fund needs to ensure that the beneficiaries of debt relief do not again accumulate excessive debt. Countries' public expenditure management systems need to be strengthened. (Arnone and Presbitero 2006)

4.1. ARGENTINA: DEBT AS A MECHANISM IN ECONOMIC CRISIS

An example of debt playing a role in economic crisis was the Argentine economic crisis. During the 1980s, Argentina, like many Latin American economies, experienced hyperinflation. As a part of the process put in place to bring inflation under control, a fixed

exchange rate was put into place between Argentina's new currency and the US Dollar. Of course a fixed exchange rate was incompatible with a structural (i.e. recurrent) budget deficit, as the government needed to borrow more US Dollars every year to finance its budget deficit; eventually leading to an unsustainable amount of US Dollar debt.

Argentina's debt grew continuously during the 1990s, climbing above \$120 billion USD. As a structural budget deficit continued, the government kept borrowing more, creditors continued to lend money, while the IMF suggested less state spending to stop the government's ongoing need to keep borrowing more and more. As the debt pile grew, it became increasingly obvious the government's structural budget deficit was simply not compatible with a low inflation fixed exchange rate - either the government had to start earning as much as it spent, or it had to start (inflationary) printing of money (and thus abandoning the fixed exchange rate as it would not be able to borrow the needed amounts of US Dollars to keep the exchange rate stable). The crisis exploded in December 2001. In 2002, a default on about \$93 billion of the debt was declared. Investment fled the country, and capital flow towards Argentina ceased almost completely.

The Argentine government met severe challenges trying to refinance the debt. Some creditors denounced the default as sheer robbery. Vulture funds who had acquired debt bonds during the crisis, at very low prices, asked to be repaid immediately. For four years, Argentina was effectively shut out of the international financial markets.

4.2. IMPLICATIONS OF DEBT SUSTAINABILITY ISSUES FOR THE IMF AND THE G-7

When the debt profile doesn't look like it's going to stabilize at a reasonable level under the most likely scenarios, not restructuring is going to be an even more costly policy—just like not devaluing a highly overvalued exchange rate leads to a larger and even more costly adjustment down the road.

If the Fund makes very large loans to countries with unsustainable debts, it's ultimately going to run into large arrears, it's going to jeopardize its relations with its key creditors, it's going to be restricted from helping other debtor countries in need, and the debt restructurings it sought to avoid are going to come anyway—albeit later at even larger cost. Just add up the Fund's current exposure to say, Argentina, Brazil, Indonesia, and Turkey—to say nothing of a highly questionable smaller case like Uruguay—and ask what happens if say, Brazil and Turkey don't make it without major debt restructurings. (Goldstein 2003)

Although, the countries that experienced the Asian crisis had high savings and investment levels, they adopted restrictive fiscal policies in order to maintain the financial liberalism and regain the trust of the international financial world. Although one may attempt to discuss the Asian crises from the neo-political view, the crises remains to be a clear the failure of international associations. Including IMF but not limited to, international financial associations failure to foresee the approaching crises and wrong policy suggestions that did not take the economic facts of the countries that fell into the crises into consideration caused a significant loss of trust to these associations. However, although Turkey experienced one of its deepest economic crises during 2000-2001 while it was following an IMF managed program, Turkey still managed to reach a more comprehensive plan with the IMF. This could be interpreted as an evidence of the lack of alternative the country was dragged into. (Celik 2007)

What do these debt sustainability issues imply about the appropriate policies of the IMF and the G-7. First, IMF surveillance has to pay much greater attention than in the past to the build-up of vulnerable external and domestic debt positions in emerging economies. Second, the Fund has to be much tougher than in the past on making debt sustainability a key condition for IMF lending. The trouble with Fund conditionality over the past decade is that

too much emphasis has been placed on things not so central—like very detailed structural policy conditions in Indonesia—and not enough emphasis has been paid to what ought to be the Fund’s bread and butter—namely, realistic real exchange rates, sustainable debt positions, and sensible macroeconomic policies. (Goldstein 2003)

5. TURKISH EXPERIENCE

Table 2 Selected Indicators of External Debt of Turkey (1996-2005) (%)

| Years | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|------------------------------------|-------|-------|-------|-------|-------|-------|------|-------|-------|-------|
| Financial Indicators (%) | | | | | | | | | | |
| Total External Debt / GDP | 43,2 | 43,8 | 46,6 | 55,7 | 59,3 | 77,9 | 77 | 60,6 | 54,2 | 47,3 |
| Public Debt / GDP | 21,9 | 20,2 | 19,2 | 23 | 24,3 | 31,6 | 35,2 | 29 | 24,6 | 18,9 |
| Private Sector Debt / GDP | 14,6 | 17,4 | 21,1 | 26,8 | 27,9 | 29,6 | 24,6 | 21,4 | 22,4 | 24,1 |
| Total External Debt / Export (FOB) | 341,8 | 320,8 | 387,9 | 426,7 | 426,7 | 362,4 | 362 | 306,9 | 256,9 | 232,2 |
| External debt Payment / GDP | 6,2 | 6,5 | 8 | 9,9 | 11 | 16,9 | 15,9 | 11,6 | 10,2 | 10,1 |

(Source: Ozkan 2006)

Since 1996 talks with IMF has been going on in a friendly environment. By implementing IMF prescriptions the Turkish authorities utilized the credibility of the IMF as well as its credits. In addition to the previous credits the IMF extended 12 billion US\$ in 2001 and it is expected this amount to grow in the near future.

Therefore it was also not unrealistic to expect that any likely future problems in the banking sector would be treated by sources other than taxes. The recent IMF rescue packages actually give some support to this argument. Thirdly, the expectation of this event should have not been associated with an expectation of radical fiscal policy. (Ozdemir 2004)

At the same time, private banks ran large currency mismatches as they exploited the arbitrage opportunity of borrowing at low cost abroad and investing in high-yield local-currency sovereign debt. The high real interest rates on lira paper offered a lucrative carry trade, given banks’ expectation that under the existing managed float the exchange rate would depreciate more or less at the rate of inflation, while the central bank would provide banks with sufficient liquidity through open market operations to ensure the roll-over of government debt. This moral hazard resulted in a substantial currency mismatch on banks’ balance sheets. Indeed, the two largest state banks eventually became insolvent, and a fundamental restructuring of state banks became necessary.

As enforcement of regulatory limits was tightened in 2000 under the IMF-supported program, banks extended foreign-currency indexed loans and bought forwards, which under prudential rules they were permitted to net out from their on-balance sheet foreign-currency position. While the quality of these hedges has been subject to debate, weak banking supervision, poor corporate governance, and the abuse of banks by their owners all contributed to the weakness of the banking sector (IMF 2004).

The banking crisis in the first half of 2001 raised great concern for the sustainability of public debt in Turkey. Following the crisis the Turkish government took ownership of 4 private banks. To rehabilitate them extra bonds equivalent in value to 13 percent of GDP were issued by the government during the crisis period. A similar operation took place for the public banks as well. In this case the issued extra bonds amounted to 8 percent of GDP to compensate their losses. As a result of those operation public debt stock increased to the

record level, which was above 60 percent of GDP in the aftermath of these operations and it is still on increasing trend. In addition to those operations 30 percent of the public debt denominated in Turkish lira (TL) was converted into foreign exchange in the same period.

Related to this event are the questions whether creditors expected such a banking crisis and if it was expected when they perceived this possibility. Did they expect a change in the government's taxation policy including inflation tax, some kind of compensation through privatization or IMF rescue packages? If we search for answers to those questions, the following information should prove useful in the process: Firstly, the fragility of the banking sector in Turkey has been frequently expressed in the reports of international financial institutions.

The 2001 program, hailed as the Turkey's Program for Transition to a Strong Economy (TSEP) included the conventional IMF austerity measures: drastic cuts in public spending, monetary contraction, flexible exchange rate management, and reductions in wage remunerations and in public employment. In particular, the TSEP has targeted a primary fiscal surplus of 6.5% to the GNP every year until 2006, and aimed at reducing the outstanding net stock of debt to 63.9%, by the end of that year. It has foreseen a real rate of growth of 5% for 2003, 2004, and 2005, and assumed an operative nominal rate of interest of 46% for 2003, 32.4% for 2004, and 27.4% for 2005. The targeted end-of-year inflation of the wholesale prices has been set at 16.2%, 12%, and 8% for the same years, respectively. Thus, the Program implicitly assumes a significant real rate of interest through its implementation.

Traditionally, the Fund's stabilization policy advice is criticized based on its implementation of an inappropriate mix of austerity measures to correct for balance of payments difficulties. Often the Fund comes under criticism that it has a dogmatic preference for fiscal prudence, often ignoring the likely negative implications for economic growth, as well as the deterioration of income distribution, regressing the living conditions of the poor and the marginalized. The current program put into operation in Turkey, on the other hand, claims a pro-growth twist. Accordingly, the severe cuts in non-interest expenditures would reduce the interest rates and would be expected to generate growth through the above narrated mechanisms of crowding-out in reverse, a mechanism which can be identified with a non-conventional phrase: *expansionary fiscal contraction*. Thus, the current IMF-led austerity program in Turkey provides a crucial test on the expansionary attributes of such fiscal contraction, and will likely have a major impact on the Fund's credibility in its capacity as a policy advisor (and as the international lender of last resort) in the age of new financial architecture. (Voyvodaa and Yeldanb 2005)

5.2. THE IMF'S VISION OF FISCAL SUSTAINABILITY AND SOLVENCY IN THE TURKISH CONTEXT

Exposures in the public and financial sector, and tight financial links between them, contributed to, and amplified, Turkey's twin banking-currency crises of 2000–01. When Turkey experienced capital account pressures in November 2000, it was about ten months into an exchange rate-based disinflation program that had shown some initial success. The reasons for these pressures—which eventually led to the floating of the currency in February 2001 and a severe output contraction—are manifold and are discussed elsewhere.. A significant share of public debt was 20 denominated in foreign currency, and, in the wake of the Russian and Brazilian crises, the maturity of this debt was progressively shortening.

The banking sector balance sheet clearly reflected this worsening economic environment. First, high inflation eroded the public's confidence in the local currency and led agents to adopt a short-term perspective. Both were evident on the liability side of banks' balance sheets: the average maturity of local-currency deposits was extremely short, and over

half of the deposits were held in foreign currency. Second, on the asset side, the public sector's large borrowing needs caused the crowding-out of private sector credit in favor of Treasury paper

Under these circumstances, an interest rate defense of the exchange rate peg could not be sustained and sharp fiscal adjustment became the only available option to stem the crisis. The initial surge in interest rates in November 2000 caused a drop in the value of banks' holdings of fixed-rate government securities and simultaneously increased their short-term funding costs. The subsequent exchange rate depreciation in February 2001 fully exposed banks' negative net open foreign-currency positions. In light of the banking sector's financial distress, foreign investors' confidence dwindled, adding to capital flight and associated pressures on the exchange and interest rates. Given the choice of exchange rate regime, only a sharp fiscal adjustment could alleviate these pressures. (IMF 2004)

5.3. TURKISH ECONOMY

When financial sources Turkey utilized in closing budget deficits are analysed, it is observed that borrowing is the main source in public financing. In this context domestic debt constitutes the main axis in domestic finance. We observe a rising trend in the ratio of domestic debt used in financing public sector consolidated budget to GNP. Such that the ratio of domestic debt to GNP is 0.28% in 1980 and the same ratio rises to 3.9% in 1989, 20-30% in 1990's and finally to 70% in 2000's. When overall debt stock/GNP is observed, this ratio happens to be 42.9% in 1997 and rise to 101% in 2001.

In the post-1980 period, setting aside the year of coup d'état, public sector deficit has increased in all years. In the post-1980 process, financing of public sector expenditures is achieved by domestic borrowing and Turkish economy did not experience severe difficulties in the first ten years since the deficits had not exceeded sustainable levels. Besides, by moderate increases in overall domestic price levels, seignorage revenue is transferred to public sector and expenditures are financed by these means.

In the post 1990 process, income redistributive policies has increased the deficits and public sector bonds are used in financing these deficits. This has been the major reason that short-term speculative capital enters Turkey since the borrowing policy of the treasury was based on high interest rates. Beyond that, FX policies pursued by governments (appreciation of Turkish Lira) have been supportive to these policies. To paraphrase, high interest rates and appreciation of local currency has been a principal reason in rushing of short-term capital movements into Turkey. In this context, "hot money" can be considered as the major factor that ignited the crisis in 1994.

Stimulated short-term and speculative foreign capital inflow finances public sector deficits as foreign savings and simultaneously accelerates imports and consumption.

We observe that foreign debt has a rising trend that is in correspondence with the finance oriented development process. Foreign debt stock has increased from 50,489 million USD to 153,160 USD and average maturity of the debt has evolved into a short-term character. Foreign debt stock of public sector has reached 67,751 million USD and domestic debt has reached 167,252 million USD which sum up to an overall debt stock of 235,013 million USD. What underlies the crisis that become more and more frequent in the finance oriented development process of Turkey is the instability that arises in rolling over domestic and foreign debt which has long exceeded sustainable levels. Increasing current account deficits in this process makes rolling over the debt stock more difficult. In the entire period, PSBR (public sector borrowing requirement) perpetually increases, except for the year 1994. Highest share in public sector deficit belongs to the budgetary deficits.

In this period, interest on domestic debt has a major weight in budget expenditures. 2001 and 2002 are years during which demands of IMF ruled the economy thus, tax revenues of 2002 are achieved by IMF policies and years of stability policies must be distinguished from others (Bildirici et al 2002). In its broader policy approach in gauging whether a fiscal position is sustainable, the IMF is observed to adhere to the following steps: (i) based on the available macro-data, a projection with a five-year horizon is made assuming that the current fiscal policy is to be continued. This is regarded as the benchmark scenario. (ii) From this projection, a path for debt dynamics is generated and its sustainability is assessed. It is possible that different criteria are used for sustainability, but an increasing debt ratio is usually regarded as a cause for concern. (iii) If the path for debt dynamics is indicated as “unsustainable”, an alternative scenario is prepared, making necessary corrections on fiscal policy variables, which will typically define a “stable path” over the medium-term. Exclusive attention is usually directed on the adjustment of the primary balance in order to meet the debt target and the fiscal measures that can generate the warranted adjustment.

In the Turkish context, given the macro targets stated in the previous section it has been a routine accounting exercise to “check” the sustainability of the Turkish fiscal position by conducting various combinations of growth, interest rate, and primary surplus. Under one such study, for instance, reports that with an output growth rate of 5%, a real interest rate of 12%, and an inflation rate of 5%, a primary surplus of 3.5% to the GNP would be needed to stabilize the Turkish debt to GNP ratio at 60%. Based on his counter-factual scenarios, Agénor further reports that an additional 1 percentage point of primary surplus would be needed for each 2 percentage points of higher real interest rates (Voyvodaa, and Erinc Yeldanb 2005).

6. CONCLUSIONS

In summary, we have shown in this paper that the risk of debt distress depends significantly on a small set of factors: debt burdens, policies and institutions, and shocks. Our results indicate that the probability of debt distress is already high in many low-income countries, and is likely to increase sharply if the large-scale development finance required to meet the Millennium Development Goals is provided in the form of concessional lending at historic levels of concessionality. We have also proposed a simple scheme of financing resource transfers to low-income countries in a way that controls the probability of debt distress, provides good incentives to borrowers, and does not involve additional donor (Kraay and Vikram Nehru 2004).

IMF members have quite different economies, face different problems necessitating adjustments in their balance of payments, and display a variety of policy regimes and different ability and willingness to implement policies to correct external payments imbalances and their underlying causes. IMF programs need to be, and are, flexible instruments for addressing those problems, within a general framework that has a quantitative dimension and imposes a The IMF Approach to Economic necessary degree of consistency and discipline across users of Fund resources. (Mussa and Savastano 1999)

Three middle-income countries: Korea, as an example of a successful country which has used efficiently high external debt in the 80s to finance investment and to reduce resource gaps over time. Argentina, as an example of a debtor country bogged down in unmanageable debt problems and high budget deficits. Malaysia as an example of a country which has avoided debt problems through careful managing of external capital flows, including capital controls.

2 low-income countries: Bangladesh with low levels of external debt and good growth prospects, and Kenya with important debt problems and high growth fluctuations.

Two HIPC's (Heavily Indebted Poor Countries), Bolivia and Uganda, which have reached the completion point under the HIPC initiative and have benefited from full debt relief, but continue to have high debt indicators. Many critics and borrowers have stated that these policy conditions often lead to negative environmental, social and economic impacts - disproportionately harming people living in poverty - and provide few tangible benefits in exchange for large increases in debt. In addition to the well-known consequences such as the increase in public indebtedness, negligible or negative growth, and socio-environmental degradation, these measures reassert a dependency of borrowing countries on 'creditors'. As a consequence of this situation, civil society organisations seeking solutions to the debt problem propose alternatives ranging from the sole acknowledgement of legitimate debts to the non-payment or condonation of debts. Several campaigns around the world seek to create awareness in poor countries of how unfair this situation is and to call the attention of national governments and IFI's (International Finance Institutions).

Incurring external debt by itself increases the exposure of the domestic economy to external influences. Consequently, debtor countries should pay attention to the impact of external financial flows on their economies and to the adequate macroeconomic management of these flows, according to their specific circumstances and level of development. Some countries, especially the low-income countries, are highly vulnerable to external shocks while having a narrow productive base. These countries need to take into account such vulnerabilities in managing their debt, often with the assistance of their development partners.

International investors care about the macroeconomic, political, and institutional settings in which issuing companies operate. Such considerations define the entry and exit points for the cross-country allocation and management of investment portfolios. The econometric analysis conducted for this report finds that a 10 percent reduction in a country's perceived economic risk decreases corporate bond spreads by 52 basis points, while a 10 percent decline in perceived financial risk reduces spreads by 63 basis points—roughly equivalent to a creditrating upgrade of two notches. The importance of sound macroeconomic management is particularly evident in the impact of higher growth and lower inflation on the spreads available to corporate borrowers. Investments in financial infrastructure to strengthen legal, regulatory, and supervisory institutions for local equity and debt markets also reduce spreads for emerging corporate borrowers.

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METHODICAL AND PRACTICAL ASPECTS OF PRODUCTION RESOURCES' ANALYSIS ON ENTERPRISE

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Abstract

The specific features of resources cost estimation methods which are characterized by firmness and lightness of error correction and untypical operations processing are explored. A primary purpose is enterprises production resources record-keeping method perfection to provide their effective forms of economic activity and operations management. The planned capitalization influencing decline calculations on expenses in production are carried out. Balance estimations of production resources are examined, those coincides with estimations liquidating types and in ordinary terms correspond to the material unit minimum cost. The research consists of founding to use expedience of resources cost estimation methods characterized by firmness and lightness of error correction and untypical operations treatment in the enterprise registration policy also.

Key words: method, estimation, calculation, raw material, standard cost, arithmetic cost, price

Introduction

Economic and social transformations in society require from the enterprise to increase production efficiency and products competitiveness. Successful enterprise activity depends on the management of material streams as inalienable attribute of production processes continuity. An enterprise independently determines the necessary amount of production resources on the stage of products purchase, production and realization. There is a necessity in development of effective registration mechanism able to co-ordinate the processes of the production resources use. This mechanism covers application of resources cost estimation optimum methods in the enterprise registration policy.

Raising of problem

The tasks of production capacities expansion are put before enterprises. It is necessary to choose variants that help to multiply the goods production volumes at the minimum materials expenses. One variant can be attractive by the low materials cost, other by the developed infrastructure. The problem solving is possible by methodical approaches which give possibility to give up «capacious» resources cost estimation methods and to be saved from fictitious income in accounting. «Exactly in market environment necessity in methodical approach, multiple search on multicriterion basis, rating estimation, alternative comparisons is determined to a great extent» [1, p. 55].

Analysis of the last researches and publications

Among the industrial and economic problems of enterprises the important role is taken by production resources cost estimation. In researches of domestic economists – Butinets F.F., V.G. Gerasimchuk, Dorofienko V.V., Zagorodnij A.G., Kuzhelnij M.V., Pavlenko A.F., Sopko V.V., Khomiak R.L. [2-9] and many others – a lot of questions related to methodical approaches to material resources estimation are explored. But quite a bit questions remain not exposed. Among them there are low efficiency of pastry production, its high material and power capacity, absence of structural changes concerning the problems of rational resource providing in theoretical-methodology and just in practical plan. The necessity of the outlined problems scientific development predetermines the article actuality.

Purpose of the article

A primary purpose is enterprises production resources record-keeping method perfection to provide their effective forms of economic activity and operations management.

Task of research

- to carry out the calculations of capitalization planned decline influence on expenses in production;
- to seize balance estimations of production resources which coincide with the liquidating types of estimations, and in ordinary terms correspond to material unit minimum cost;
- to found use expedience of resources cost estimation methods characterized by firmness and lightness of error correction and untypical operations treatment in the enterprise registration policy.

Research methods

Scientific research methodology is based on the use of methodical approaches to the evaluation of resources cost. For realization of the put tasks the methodical receptions, technical-economic calculations, analytical groupments, analysis, generalization were used.

Basic material of research

There are situations at enterprises, when realization of forward measures either does not bring the planned results or their problems solving can exceed the expenses of raw material and materials in indexes are generated. It is predetermined by low efficiency of domestic production, high him material- and power capacity, absence of structural changes in relation to the problems of the rational resource providing.

The methods of estimation of cost of supplies to a certain extent do not take into account principles of exactness and objectivity of record-keeping (account of operations of returning) [10, c. 178]. But without regard to absence of references to principles of account, by an author the done attempt to give estimation to exactness of forming of financial result. Calculating the index of financial result (income), an accountant regulates registration information (charging amortization). Adjusting changes an income. Capitalization, as reception, adjusting gives

possibility to represent expenses which will bring profits in subsequent periods not in a report about gains and losses, and in an asset or passive voice of balance. Accumulation of reserves on the losses or depreciations of supplies is the example of passive capitalization of material account [11, c. 56]. It is thus expedient to consider the method of average sliding cost, method of cost average for period, FIFO, method of calculation of cost of unit of supplies, method of standard cost, method of grade cost, method of taking cost of inventory, method of arithmetic cost.

For calculations we will enter indexes: s it is sum, q is amount, p is price. For sums, amount and costs of receipt we use the overhead index of «+», for expenses is overhead index «-». By a lower index we mark a period, time, number of operation. For initial and eventual balance we enter an overhead index a and b . Under unit of supplies we understand physical unit of measuring of amount of materials.

Method of FIFO and method of calculation of cost of unit of supplies similar to the method of part account. In the methods of part account after every purchase party of materials the individual cost of unit of supply is kept. We will assume that k is number of party, i is number of unit of supply. Then purchase prices are kept for every made index (i, k) . «Reproduction» of production supplies in accordance with the order of receipt of party of materials is thus carried out. The difference of methods consists in treatment of expense operations, in particular operations of vacation. After the method of FIFO supplies are released in accordance with the order of their receipt: the first copy off the more «oldest» materials. The casual number of cost from party of materials, which is released in production, gets out pursuant to the method of calculation of cost of unit of supplies.

We will consider the method of sliding average cost. For every type of materials we enter a middle price which we transfer after every operation of purchase of materials:

$$p = s / q \quad (1)$$

At receipt of party of materials in a sum s_i^+ , by an q_i^+ amount a middle price is evened:

$$p_{i+1} = \frac{s_i + s_i^+}{q_i + q_i^+} + \frac{s_{i+1}}{q_{i+1}} \quad (2)$$

During realization of materials we calculate their cost after a formula:

$$s_i^- = q_i^- p_i = q_i^- \frac{s_i}{q_i} \quad (3)$$

At released materials after the method of sliding average cost the middle cost of unit of supplies does not change to a certain extent. Operations from the receipt influence on the middle cost of unit of supplies.

Table 1 Register of materials receipts and expenses

| m - period I - operation | Initial remain | Receipt | Expenses | Eventual remain |
|-----------------------------|---------------------|----------------------------|----------------------------|---------------------------------|
| | Initial balance | Debiting appeal | Credit appeal | Eventual balance |
| Sums | $s_m^a = s_{m-1}^b$ | $s_m^+ = \sum_i s_{m,i}^+$ | $s_m^- = \sum_i s_{m,i}^-$ | $s_m^b = s_m^a + s_m^+ - s_m^-$ |
| Amount | $q_m^a = q_{m-1}^b$ | $q_m^+ = \sum_i q_{m,i}^+$ | $q_m^- = \sum_i q_{m,i}^-$ | $q_m^b = q_m^a + q_m^+ - q_m^-$ |

At the use of method of cost average for period a middle price is transferred on beginning or end of period and does not change during a certain period. In the Internal revenue code of Russia in the method of calculation of cost average for period a middle price is calculated on the end of period taking into account all receipt of materials. Such approach to a certain extent is inadvisable, as it is needed to calculate the prime price of shipping of every party of materials, and also during a period it is needed to expect the middle prime price of materials. This there can be a middle price on beginning of period, or middle price, that is expected by the method of sliding average cost, or in general some conditional value of cost. In addition, at the end of month, taking into account the receipt of materials, it is required to calculate a «actual» middle price, to transfer the prime price of the realized materials during a period and carry out correction of wiring [12, c. 57]. At application of method of cost average for period a price can be formed on beginning or end of period. If a middle price settles accounts on beginning of period, she doesn't change during a period and the deferred incomes influence only on the middle cost of a next period. If a middle price is calculated on the end of period, the deferred incomes influence on the middle cost of current period and it settles accounts upon termination of period. For the calculation of middle price we suggest to use a table – register (table1), where information about a sum and amount of supplies on beginning and end of period accumulates, sums and amount of receipts of materials and expense.

Cost of resources unit:

$$p_m = \frac{s_m^a}{q_m^a} \quad (4)$$

Cost of release:

$$s_{m,i}^- = q_{m,i}^- p_m = q_{m,i}^- \frac{s_m^a}{q_m^a} \quad (5)$$

Middle cost of unit of material on the end of period:

$$p_{m+1} = \frac{s_m^b}{q_m^b} = p_m + \frac{\delta_m}{q_m^b} \quad (6)$$

As at the calculation of middle cost of rejection insignificant, it is expedient to enter the standard cost of unit of supplies. The standard cost of receipt is calculated as sum of acquisition in standard prices. Thus there is a question, namely: to take into account rejection in a lump sum or distribute the lump sum of rejections on every unit of supplies; how to copy off the accumulated rejection on a financial result.

We will designate o is deviation from a standard cost, indexes at variables are similar, p is standard cost, z is cost of purchase. Rejection and standard cost of purchase we expect:

$$o_i^+ = z_i^- - q_i^+ p \quad (7)$$

$$s_i^+ = q_i^+ p \quad (8)$$

Copying off rejection is possible both after every operation and non-permanent at the end of certain period. If we copy off rejection in account of certain period (month), the sum of rejection needs to be accumulated in a certain register, above all things on the certain account. Consequently, if m is period, the accumulated rejection for period is evened:

$$o_m^+ = \sum_i o_{m,i}^+ = \sum_i (z_{m,i}^+ - q_{m,i}^+ p) \quad (9)$$

Sum of rejection, which we copy off on a financial result we expect by a few methods, namely: 1 method - fully we copy off rejection: $o_m^- = o_m^+$; 2 method - we copy off positive rejection, negative - we fix on the account: $o_m^- = o_m^+$, $o_m^+ > o$; 3 method - we copy off rejection proportionally to part of the realized materials. If for period the receipt was not, we expect a coefficient as attitude of initial balance toward a credit turn (expenses): $\gamma_o = \frac{s_m^-}{s_b^a}$. At the receipt

of materials and their partial vacation, we go into detail a coefficient taking into account acquisition: $\gamma_1 = \frac{s_m^-}{s_m^a + q_m^+ p}$ or $\gamma_2 = \frac{s_m^-}{s_m^a + z_m^+}$, where z_m^+ is actual cost of receipt.

$$\gamma_3 = \frac{q_m^-}{q_m^a}, \gamma_4 = \frac{q_m^-}{q_b^a + q_m^+}.$$

We expect the sum of rejection after a formula:

$$o_m^- = \gamma(o_m^a + o_m^+) \quad (10)$$

4 method. We copy off rejection to the level of importance $\left| \frac{o_m^+}{s_m^a + s_m^+} \right| > \varepsilon$. The level of importance $\varepsilon > o$ is to be about 5% in accordance with the sum of assets or sum of tailings. Thus, if the remain of materials on composition is small, we copy off rejection fully. On condition of far of materials on composition we expect: $\frac{o_m^+}{s_m^a + s_m^+} > \varepsilon$, than

$$s_m^+ + \sum_j q_{m,j}^+ p_{m,j}^+ . \quad (11)$$

On condition of correct calculation of standard price rejection hesitates near a zero. Thus positive rejections of receipts of supplies are compensated negative and account balance of rejections approaches a zero. On occasion the average cost of purchase undertakes for a standard cost. A standard cost can come forward a price reference point. For purchase departments she represents the standard of prices of purchase of materials, for sales departments - minimum cost of release of materials. In practice it is expedient to take the liquidating value of supplies for a standard cost. A standard cost must be looked over not more frequent once on a year, as the method of cost average for period, which is «encumbered» with procedure of calculation of rejections, is actually used here. It costs to recommend to use on an enterprise the method of middle price, after which a middle price does not change the protracted period. Possibility of influence on the level of capitalization of expenses at the purchase of materials is advantage of method of standard cost.

The method of grade cost of supplies complements the method of standard cost of supplies, but at his introduction conditional denotations are used. Applying the method of writing of rejections, we will enter the fixed numbers of costs. For a standard prime price we will accept: 1, 2, 5, 10, 20, 50, 100, 200, 500, 1000,.... We will fix the index of standard cost in the codes of classification groups of production supplies. It is not thus expedient to keep information about the cost of every unit of supplies. If cost of material 1, it is here possible to give up quantitative registers, as a sum register is actually quantitative. Calculation of quantitative and sum registers:

$$o_m^+ = z_m^+ - s_m^+; \quad (12)$$

$$o_m^- = (o_m^a + o_m^+) \frac{q_m^-}{q_m^a + q_m^+}; \quad (13)$$

$$s_m^b = s_m^a + s_m^+ - x_m^- \quad (14)$$

where j is number of the proper grade of cost of material, in particular, $q_{m,j}^+$ is amount of materials of grade j , which acted in a period m , $q_m^\bullet = \sum_j q_{m,j}^\bullet$.

It costs to notice that rejection in the method of grade cost can exceed the absolute value of grade cost. If rejection is copied off on a financial result, at small prices it is expedient to account the cost of supplies on the prime price of release of materials on the measure of their receipt. In the method of taking cost of inventory the cost of the realized products is calculated by the decision of balance equalization: $s_m^b = s_m^a + s_m^+ - x_m^-$,

from equalization swims out: $x_m^- = s_m^a + s_m^+ - s_m^b = s_m^+ - (s_m^b - s_m^a)$.

The sum of ware-house remain of materials on beginning and end of current period settles accounts. During taking of inventory is determined the amount of materials on composition. The cost of material can coincide with the certain real price in the moment of the last purchase. She can be a conditional or middle price, standard or standard cost. We will designate through p - cost of unit of material and we will get inequality for account balance from the account of materials: $s_m^a = q_m^a p$; $s_m^b = q_m^b p$.

The method of taking cost of inventory contains the principle fixed in basis of method of standard cost (normatively set cost of unit of supplies). We will compare these methods and their influence on a financial result.

We will assume that p is standard cost, z is purchase cost, q^a is initial remain of materials on composition, α is particle of the realized materials from composition in the analysed period in accordance with an initial remain on composition, αq^a is amount of the realized materials, β is particle of purchases of materials in the analysed period pursuant to an initial remain on composition, βq^a - amount of the acquired materials. A registration register is following (table 2):

Table 2. Registration register

| | Beginning of the period | Receipt | Expenses | End of the period |
|----------------------|-------------------------|---------------|-----------------------------------|--------------------------------------|
| Quantitative account | q^a | βq^a | αq^a | $q^a (1 + \beta - \alpha) = q$ |
| Sum account | $p q^a$ | $z \beta q^a$ | $x = (\beta(z - p) + \alpha p) q$ | $p q^a (1 + \beta - \alpha) = p q^b$ |

At $x < o$ prime price of vacation is negative. We explore at what terms $x < o$. We will get inequality: $z < p(1 - \frac{\alpha}{\beta})$.

A coefficient α / β characterizes attitude of the acquired materials toward the amount of released. The reverse relation β / α shows the amount of periods of the realized materials. At $\alpha \geq \beta$ cost of release of materials more of zero. At $z > p$ purchase cost of supplies more of

standard cost. If $z < p$ the cost of release of materials will be negative. Exceeding (diminishment) of cost of vacation of materials above a standard cost makes: $\Delta = q^a \beta(z - p) = q^+(z - p)$.

We use the method of arithmetic cost in default of natural (in units) account of production supplies. We will assume that is w_m profit of m - 20 period. We will set a percent, in particular certain normative part of prime price from a profit. A coefficient $1 - p$ answers a margin. Consequently, the prime price of realization of supplies and sum of ware-house tailings is determined: $s_m^- = pw_m^-$; $s_m^b = s_m^a + s_m^+ - pw_m$.

Conclusion

Research of different resources cost estimation methods gives possibility to make such conclusions. According to this method, the greater is part and positive rejection and the earlier it is copied, the less is capitalization incident degree. A situation changes conversely for negative rejection. The method of grade cost at the correct price grades setting is able to deprive capitalization to a certain extent. For this purpose it is necessary that the grade cost is less than purchase and basic part of cost rejection from the grade copied in the receipt period. Consequently, expenses capitalization causes the income tax increase. Tax base and accordingly income tax diminishes at the capitalization decline. If to ignore fiscal aims of account, for estimation of directly enterprise activity it is expedient to diminish the capitalization degree, as it will provide «equivalent» income estimation [13, c. 189]. Thus it is needed to take into account other peculiarities of methods. Among them there are material resources economy, registers calculation complication, firmness of methods to the errors, lightness in the reflection of untypical operations (operation of materials returning). In the section of inventories account it is necessary to include recommendations which determine the methods of reflection and production recourses cost estimation variants at different registration situations. Taking into account all advantages, the methods of standard, grade and arithmetic cost are more expedient.

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AN ANALYTICAL STUDY OF STRESS MANAGEMENT ON EXECUTIVES IN LUCKNOW CITY & NEW PERSPECTIVES FOR UNDERSTANDING STRESS IN ORGANIZATIONAL CONTEXT

S. Athar Mahmood* & Gaurav Bisaria**

Abstract

The contingencies of modern life have changed the scenario for people today. New aspects have crept into life styles due to hectic work schedules and pressures. Stress is one such aspect that is receiving unprecedented attention from practitioners and academicians alike. Needless to say, stress is present in every one but shows up in some people more than others, the cause of which is a wide area of research. This paper aims to fill in the above mentioned information by investigating the causes of stress on executives. In the initial part of the paper, stress is discussed in detail and supported by information and facts. Some remedies to counter stress are also mentioned.

In second part, the research and its findings are described which was conducted on executives in Lucknow city. The results are shown through figures as well as described in detail. The main causes of stress are listed out as shown through the research. Based on this research, three new perspectives have been developed to understand stress in organizational context. The first approach is quantitative in nature and includes certain important variables like bad performance, inter personal relations, health problems and obsolescence. The second approach is qualitative in nature and depicts how stress aggravates in people.

The final approach describes a sort of tussle between stress and 'anti stress' measures and hence is termed as Counter Balance approach. Conclusions are drawn from the research as well as from the new proposed perspectives and include a complete picture of how stress is being tackled by executives themselves as well as from efforts by organizations.

INTRODUCTION

Modern life is full of problems of all kinds. These problems range from completely personal to those arising out of organizational issues. Whatsoever the nature of problems, it takes its toll on human beings and the direct result is what is termed as stress. STRESS is the word, which is becoming very popular these days among the corporate houses. There is increase in stress due to development of cities, coming up of big companies, more work and more production. It is being said that stress can kill one person a day. Stress is used in Engineering which means pressure of an object over another and was introduced in Social Sciences by HANS SELYE in 1936. Stress came in limelight around 1990's and accelerated in 2000. Stress is defined as the condition that results when person-environment transactions lead the individual to perceive a discrepancy, whether real or not, between the demands of a situation and the resources of the person's biological, psychological and social system. In simpler words, stress is the result of adverse situations that a person faces continuously, the most likely result of which is negative in nature.

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Stress can develop one into a on-performer. Studies suggest that 1 in 5 people suffer from stress. It is generally being said that one can fight very well with stress when he is in the age group of 18yrs. to 40 yrs. and after 40 yrs. the power of fighting with stress goes on decreasing. According to Prof. Hari Shanker Sharma of Neurobiology (at the Department of Surgical Sciences, University Hospital of Uppsala University Sweden) Indians have to face hardships as years are wasted for completing a simple task and till 40 yrs. they are just able to bring things on level and when time comes to show performance they might have crossed 40 yrs., which leads to low performance and hence stress. According to Corporate Persons, peoples are taking retirement at the age of 45 yrs. due to excessive stress and are moving to peaceful or religious place where they can have peace of mind or can forget the tensions by devoting themselves to God.

‘Stress’ means physical or mental over-exertion that disturbs natural physiological balance of the body. Stress is the "wear and tear" of our bodies’ experiences. Stress affects our health as well as our working performance. Job Stress can be due to environmental factors like political, economic and technological. There is no single level of stress that is optimal for all people, what is distressing to one may be a joy to another. One cannot know stress until and unless they have experienced it and when you feel it then some can take it while others cannot. It is difficult to relate stress with the nature of business i.e. there is more stress in I.T. Sectors or in Banking Sectors and not in others but this is not true as more things depend on organizational culture and the nature of bosses

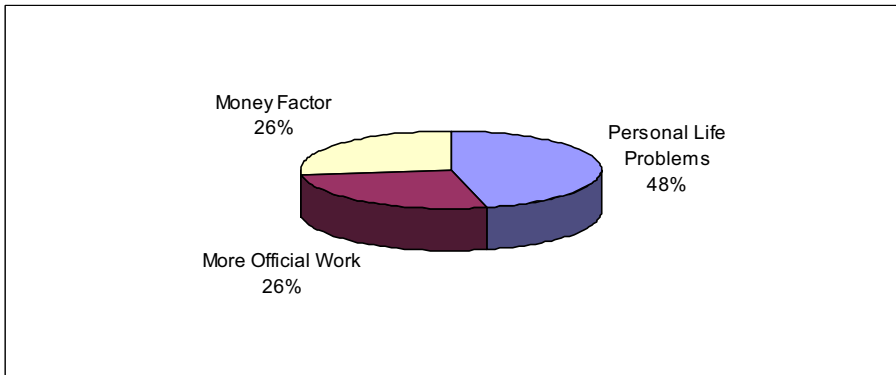
THEME:

- Research was conducted among working class, both males and females, to understand the reasons and impact of stress.

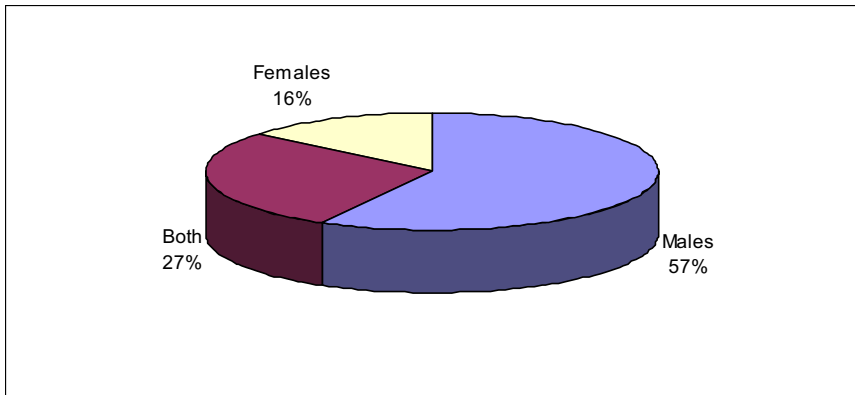
RESEARCH METHODOLOGY

Sample Size: 200, Population: 100 Males & 100 Females, Data Collection Instrument: Questionnaire, Demographic: Executive Male & Females and Geographic Location: Luck now, UP. Where possible, information was collected through informal interviews.

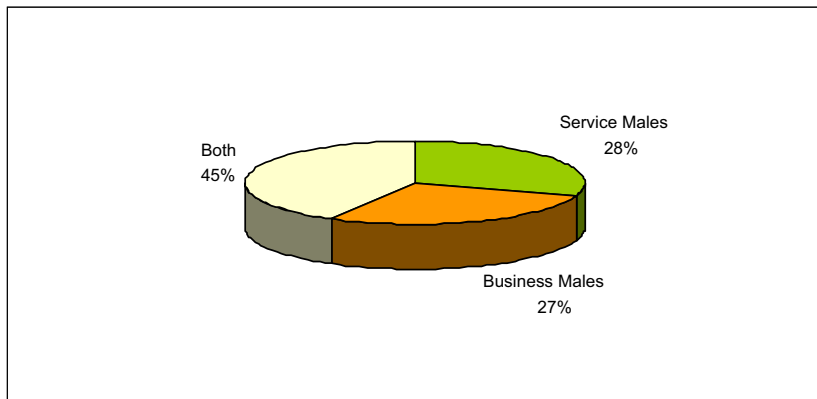
REASONS OF APPEARANCE OF STRESS



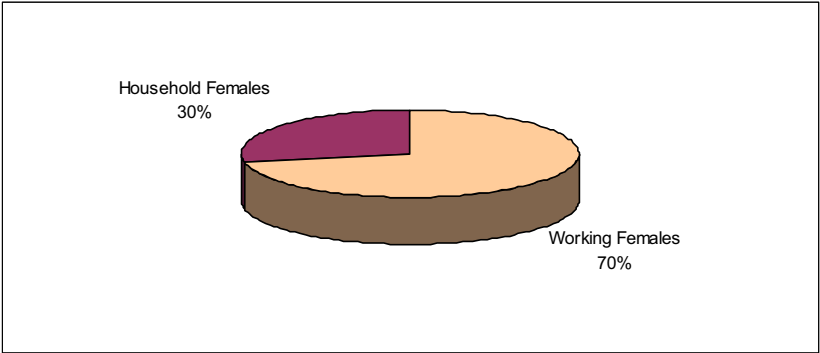
KNOWING THE IMPACT OF STRESS ON MALES AND FEMALES



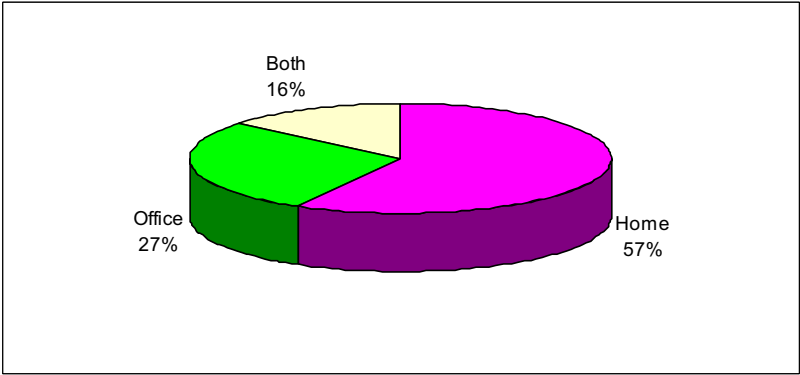
KNOWING THE IMPACT OF STRESS ON SERVICE MALES OR BUSINESS MALES



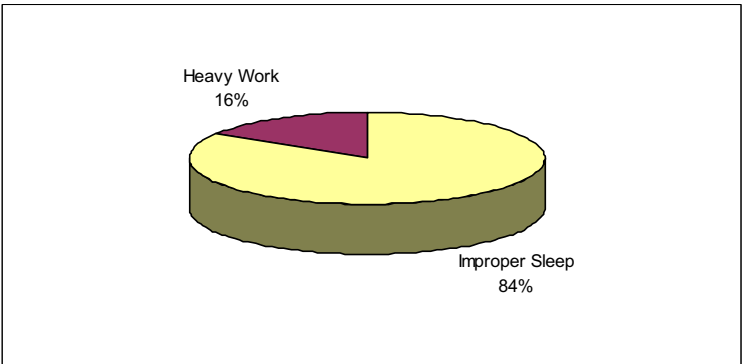
KNOWING THE IMPACT OF STRESS ON WORKING FEMALES & HOUSEHOLD FEMALES



SHOWING LINKAGE OF STRESS WITH HOME OR OFFICE



KNOWING THE IMPACT OF HEAVY WORK OR IMPROPER SLEEP ON PRODUCTIVITY



Note: This is the data according to the research conducted among executives of Lucknow City as described in Research Methodology above.

FINDINGS OF THE RESEARCH

(a) According to research conducted, 48% of the sampled executives of Lucknow City say that the reasons for appearance of stress is Personal life problems while according to 26% the reason is money factor and according to 26% more official work.

(b) 57% say that the impact of stress is on males while according to 16% the impact is on females and according to 27% the impact is on both equally.

(c) 28% say that the impact of stress is on service males while according to 27% the impact is on business males and according to 45% the impact is on both equally.

(d) 70% say that the impact of stress is on working females while according to 30% the impact is on household females.

(e) 57% say that there is linkage of stress with home while according to 27% the linkage is with office and according to 16% the linkage is with both.

(f) 84% say that productivity is affected by improper sleep while according to 16% say heavy work affects productivity.

Therefore the main causes of stress are:

- Due to work-place
- Due to change in job
- Rare promotions
- Improper infra-structure
- Insufficient no. of employees for performing tasks
- Women competing the men
- Overwork
- Culture dominance
- Reduced packages
- Lack of motivation
- Lack of communication between different management levels
- Conflict between different management levels
- Training is not proper
- Tools or machines are not proper
- Performance standards are not proper
- Single person is doing lot of jobs
- Person is doing lot of overtime
- Caffeine i.e. starting a bike or scooter
- Pollution
- Improper food
- Lack of fresh air and natural light
- Radiations of mobile phones and computers

So, stress, in organizational context, can be understood from three new perspectives that are proposed below:

- 1) Mathematical Approach
- 2) Signal Approach
- 3) Counterbalance Approach

1) In the **Mathematical approach**, stress can be described by assessing its level for an individual at workplace. This level can be denoted by the equation

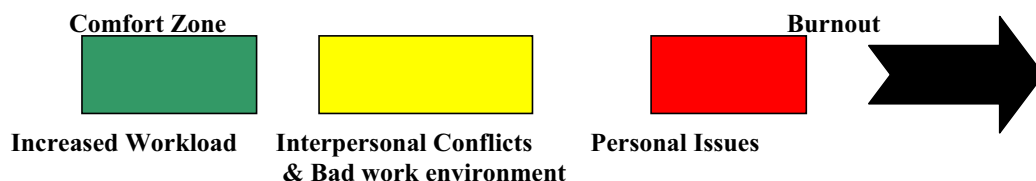
$$\text{Level of Stress} = \text{Burnout} - \text{Current state of Individual}$$

The two variables on the right side of the equation would determine the actual level of stress. The more important of these is burnout, which happens to be the last stage before an individual gives in to stress completely. This Burnout situation is a result of:-

- a) Consistently Bad performance which can be described in terms of both quality and quantity. (The individual may have received several warnings for the same).
- b) Poor Interpersonal relations which includes those with boss, peers, subordinates and relations with friends and family.
- c) Depreciation in skills/value and a feeling of obsolescence which convinces an individual of his worthlessness and lack of contribution.
- d) Serious Health hazards and other problems related to personal health.

The individual's current state needs to be measured and understood which has to be compared with the burnout situation. The difference between the two denotes the level of stress. Needless to say the more the difference, the lesser stress level of the individual and vice versa.

2) The **Signal Approach** can be described as a qualitative approach but the main variables remain the same as in Mathematical Approach. Diagrammatically, this model can be described thus:



An individual remains a 'normal person' when he has little work pressure and can be said to be in the Comfort Zone. This situation is most desirable and has been depicted on the extreme left side of the diagram. As workload and work pressure increases, the individual moves over into the Green zone. This is also a safe region but stress begins to mount up from here only.

When the individual comes across hurdles in this increased work and the result is interpersonal conflicts and bad work environment, he crosses over into the Yellow Zone. This is an Intermediate region from where an individual starts feeling the effects of stress and as he moves deeper into the yellow area, he moves more and more away from the comfort zone.

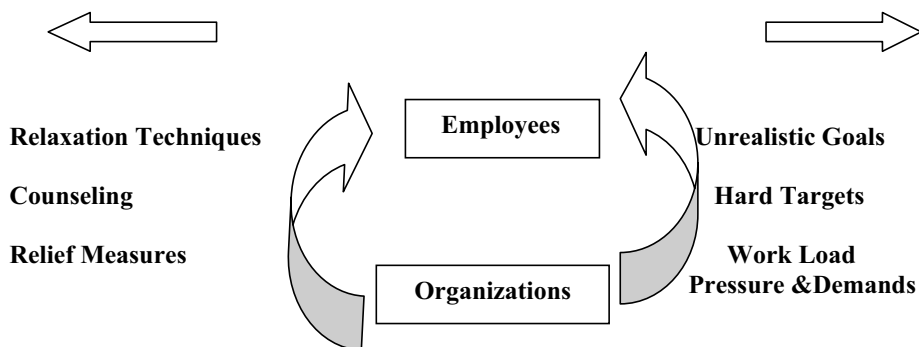
Finally, the situation turns alarming when personal issues also show up. The adverse circumstances take the individual into the Red zone which can also be termed as the Danger Zone. Stress levels are quite high and as stress compounds, the person starts moving towards the Burnout region (denoted in black colour and at the tip of the arrow).

This approach does not measure stress but can help understand where a person stands in terms of his stress level.

3) The Counterbalance Approach can be understood in terms of employer and organizational efforts to help employee counter stress. It can be represented thus:

Comfort Zone

Burnout



The organizations provide stress on one hand through unrealistic goals, hard targets, increased workload and work pressure. On the other hand, they provide counseling, relaxation techniques and other relief measures to help employees counter and reduce stress. Since both are result of organization's efforts, they act in different ways on the employees:

a) If the counter measures succeed, the employee moves towards the Comfort Zone despite stress. Richard Lazarus described stress as functioning in two ways- the positive side which he termed as eustress and the negative side called distress. While the former may motivate individuals to in the form of challenges, it is the latter that is more important from the academic viewpoint. In organizations, stress is mostly taken in the negative sense and steps are taken to counter the same. This can also be termed as the Eustress as propagated by Lazarus.

b) If the counter measures are weaker in comparison, the employee faces more and more stress moving towards the Burnout stage. In such cases, organizations need to review their HR policies.

These three approaches can be used for explaining and analyzing stress on individuals in organizational context.

CONCLUSION

Many people are of view that by doing yoga and meditation during or before office hours can increase one's capacity of doing work and can make him energetic completely for 24 hours. They must be made mandatory in offices. Prayers of any religion in morning, afternoon, evening or in night i.e. before, during or after working hours can help overcome stress.

B-Schools are also taking the lead from corporates. They are having compulsory yoga modules, as their brochures show. They are also trying to have compulsory mediation modules. In schools or in colleges the exercise and prayers are already in use. They are rooting the foundation early, and hopefully, minimizing the stress the candidates may face in their careers during studying or later in life.

Mind is the master sense of human beings. Its fitness and efficiency is highly important in rating the performance of a person. Heart is the centre for the functioning of the complete body. There should be proper balance between mind and heart. Our mind and heart must be kept in proper form by handling negative feelings, emotions and strain. This can lead to STRESS FREE LIVING which can further lead to INCREASE IN PRODUCTIVITY.

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THE IMPACT OF FOREIGN PRIVATE INVESTMENT (FPI) ON CAPITAL FORMATION IN NIGERIA, 1980-2004: AN EMPIRICAL ANALYSIS

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Abstract

A number of possible determinants of capital formation is investigated using Nigerian data covering 1980-2004 studied. Time-series estimates are obtained using an OLS methodology which included tests for stationarity and cointegration. Empirical results showed a positive influence of cumulative foreign private investment (CFPI), index of energy consumption (INDEXEC) and total banking system credit to the domestic economy (BSTCr), and a negative influence of gross national savings (GNS), domestic inflation rate (INFR), maximum lending rate (MLR), foreign exchange rate EXCHR and debt service ratio (DSR) on capital formation. We discovered that foreign exchange rate leads capital formation in Nigeria, followed by index of energy consumption and then, debt service ratio. The paper therefore recommends reduction in exchange rate distortions/misalignment; increase in exports of locally manufactured goods and raw materials to raise value of local currency; earn more foreign exchange and allow market forces to fix exchange rate; increase in energy supply by providing constant electricity and infrastructure to boost industrial energy consumption; and continuous minimisation of foreign debts to reduce amount of national income used for debt servicing.

Key words: Foreign private investment, Capital Formation, Determinants, Impact, Banking system credit, Index of energy consumption

Classification: Research Paper

1. Introduction

In the late 1970s and early 1980s, most developing countries of Africa (including Nigeria) experienced unprecedented and severe economic crisis. These crisis manifested itself in several ways such as persistent macroeconomic imbalances, widening saving-investment gap, high rates of domestic inflation, chronic balance of payment problems and huge budget deficit (Akpokodje, 1998).

Although different reasons have been adduced for the slowdown of these economies, Greene and Villannueva (1991) attribute the problem to the decline in investment rates in the affected economies. In Nigeria, for example, Akpokodje (1998), maintained that domestic investment as a ratio of gross domestic product (GDP) declined from an average of 24.4% during the 1973-1981 period to 13.57% during 1982-1996 period. The average investment rate during the 1982-1996 period implied that the country barely replaced its dwindling capital. In the same vein, private investment rate depreciated from 8.6% in 1973-1981 period to 4.2% in the 1982-1996 era. Due to the fact that investment determines the rate of accumulation of physical capital (otherwise called capital formation), it then becomes a vital factor in the growth of productive capacity of the nation and contributes to growth generally. It is in the light of this that prominence is being attached to increasing the magnitude of real asset investment in the economy.

In particular, central to the less than satisfactory growth registered by countries of sub-

Saharan Africa is low level of investment as a result of low domestic savings. Attracting foreign investment is therefore crucial from a number of standpoints and of course, there is never shortage of theoretical arguments (Chete, 1998). First, consistent and regulated inflow of foreign investment provides an important source of foreign exchange earnings needed to supplement domestic savings and raise investment levels. Second, import substituting investment would serve to reduce the import bills as investment in export industries will directly increase the country's foreign exchange earnings.

Some other benefits might also accrue from increased foreign investment. These include the creation or rather expansion of local industries to supply inputs to the newly established plants; a rise in the overall level of domestic demand to boost incomes and, through taxation, state revenues; and the transference of labour (human capital) skills and technology. Yet another set of benefits arises from the forecasting of efficiency in the domestic economy, an effect that might even occur prior to the anticipated investment flows (Chete, 1998).

Most probably due to these overwhelmingly attractive theoretical arguments in support of foreign investment, government authorities in Nigeria have often articulated a plethora of incentives aimed at attracting foreign investment. For example, the *New Industrial Policy* published in 1988 embodies some Foreign Direct Investment (FDI) provisions which represent a dramatic departure from the past policy (see Chete, 1998, for details).

Besides, the need for external capital inflow arises, when desired investment exceeds actual savings. They are necessary also owing to investments with long gestation periods that generate non-monetary returns; growing government expenditures that are not tax-financed and when actual savings are lower than potential savings owing to repressed financial markets, and even capital market flight (Ogamba, 2003).

Several variables which create dependence on foreign capital have been identified in the literature. They could be classified into fluctuating variables such as exports, imports and invisible; offsetting variables like debt service and reserve creation, and rigid variables which include minimum level of imports, stage of economic development and exportable surplus (Ogamba, 2003).

External capital flows could also be non-debts creating flows (as in official transfers or grant in aids and direct investment flows), debt creating flows (as in official development finance), commercial bank loans and international bond offerings; or could equally be a hybrid, for example, foreign portfolio investments and international equity offerings. Of late, Nigeria has embarked upon several trade liberalisation policies so as to free FDI flows into the country (Adegbite and Owuallah, 2007).

The literature is replete with evidence that private investment in most developing countries is more directly related to growth than public investment (see Akpokadje, 1991; Serven and Salimano, 1991; Khan and Reinhart, 1990). Accordingly, it is now widely accepted that the expansion of private investment should be the added impetus for economic growth in developing economies (Chhibber and Dailami, 1990).

Many developing countries have over the years relied very much on the inflow of financial resources from outside in various forms, official and private capital flows as well as direct foreign investment, as a means of speeding up their economic development (Olaniyi; 1988, Odozi, 1995; Ekpo, 1997 and Uremadu, 2006). However, these countries have shown preference for direct foreign investment because they regard direct foreign investment as a means of counteracting the sluggish trend in official and private portfolio capital flows.

Generally, capital from outside can be very helpful in speeding up the pace of economic development and can act as a catalytic agent in making it possible to harness domestic resources particularly in a developing country. But foreign capital, no matter how large the inflow, cannot absolve a recipient country from the task of mobilising domestic resources. Foreign inflows can,

at best, be complementary to domestic savings. In developing economies experience has shown that foreign capital alone cannot create any permanent basis for a higher standard of living in the future. Rather it complements domestic savings. Therefore greater dependence on internal sources of finance facilitates the successful implementation of any planned economic development in a country (Agu, 1988 and Uremadu, 2006).

But after over two decades of economic adjustment, all relevant indicators have suggested that the recovery of private investment in Nigeria has been sluggish and slow. The figures in Table 1 of Appendix I, for example, show that cumulative foreign private investment as a percentage of GDP, has been fluctuating over the years 1980-2004. It has also followed a downward trend from the position of 7.12% (1980) to a peak of 12.79% (1986) and to its current status of 3.73% in 2004. The same low and fluctuating trend has been exhibited by the gross domestic investment also known as Gross Fixed Capital Formation (GFCF). Certainly, macroeconomic policies: monetary, fiscal and exchange rate, have a bearing on the investment behaviour in a country (Likewelile, 1997, Ghuma and Hadjmichael, 1996; World Bank, 1994 and Akpokodje, 1998), but the impact of these policies on private investment behaviour in Nigeria is still largely unclear.

This paper therefore explores the association existing between capital formation and other macroeconomic indicators of interest in the pursuit of macroeconomic policies in Nigeria. Specifically, it seeks to determine the impact of cumulative foreign private investment on capital formation and growth in Nigeria. It will also highlight the complementary role played by it to gross domestic savings towards filling the existing savings - investment gap in a bid to achieve desired investment goals and/or growth objectives in Nigeria in the years ahead.

2. Literature Review and Theoretical Framework

This section will attempt to review some outstanding existing related studies on the topic of research and finally, review relevant theoretical framework on the main issue of study.

2.1 Review of Related Works¹

The preponderance of empirical studies that have explored quantitatively the determinants of foreign direct investment have concentrated more on economic than other factors. In particular, each of the authors, in his regression equations included those determinants he or she considered personally appealing. In what follows, we survey some of these empirical investigations.

A leading proponent of the economic approach to the determinants of foreign direct investment is found in (Dunning, 1973). On the strength of studies by scholars based on international production, he identifies three sets of influences on foreign direct investment to include the following:

- i. market factors such as the size and growth of the market measured by the gross national product (GNP) of the recipient country;
- ii. cost factors such as the availability of labour, low labour costs and inflation; and
- iii. the investment climate as measured by the degree of foreign indebtedness and the state of the balance of payments (Chete, 1998).

In another study, Dunning (1981), develops an eclectic theory of international direct investment based on the theories of industrial organisation of location of a firm. Nonetheless, the treatise of this later study does not directly concern the subject in hand (see Chete, 1998, p.4).

Agarwal (1980), clarifies the determinants of foreign direct investments using two political factors of political stability and the threat of nationalisation, in conjunction with a variety

of economic factors such as investment incentives, the size and growth of the recipient's market, its degree of economic development proxied by infrastructure, market distance and economic stability in terms of inflation, growth and balance of payments. In his extensive survey of the literature on the determinants of foreign direct investment, he finds mixed evidence with respect to the impact of political instability.

Lewis (1978), lays emphasis, to some extent, on political factors too. He tested the dual hypotheses that economic considerations are the prime determinants of foreign investment flows and that political variables are of secondary importance. His model uses a step-by-step regression for 25 developing countries from three continents: Africa, Asia and Latin America to establish that economic variables are more important than the political ones.

All the above studies except, Dunning (1981), were pre-occupied with the determinants of foreign direct investment in developing countries. A respectable number of studies have also been conducted for developed countries particularly for the United States and the European Community (eg., see, Scapellato and Balough, 1983 and Lunn, 1980). The authors established similar findings.

Back home in Nigeria, significant scholarly effort has gone into the study of the role of foreign direct investment in the Nigerian economy. For instance, Oyaide (1979), provides an excellent documentation of works conducted under the umbrella of Nigerian Economic Society (NES). What follows draw substantially from this brilliant summary as reported in (Chete, 1998).

The preoccupation of Edozien (1968), is on the linkages generated by foreign investment and their impact on Nigeria's economic development. Specifically, he contends that foreign investment induces the inflow of capital, technical know-how and managerial capacity which interactively will accelerate the pace of economic development, while attenuating the pains and uncertainties that come with it. Furthermore, he observes that foreign direct investment could be counter-productive if the linkages they spur are neither needed nor affordable by the host country. Conclusively, he suggests that a good test of the impact of such investment on Nigeria's development is how rapidly and effectively it fosters local enterprises to innovation.

In a related study, Largely (1968), posits that foreign direct investment has both benefits and repercussions in the context of Nigeria's economic development. While FDI could accelerate growth through the infusion of new techniques and managerial efficiency, she however warns that it could worsen the balance of payments position. She stopped short though, of elaborating the channels through which this can be actualised. Foremost, Olakampo (1962), has alluded to this negative fall-out of FDI when he argues that foreign aid in the form of direct investment and portfolio investment generally imposes a burden of repayment in form of capital outflows on the recipient country.

Oyaide (1977), concludes, using indices of dependence and development as mirror of Nigeria's economic performance, that direct foreign private investment (DFPI) engenders both economic dependence and economic development. In his view, DFPI continuously causes and catalyses a level of development that would have been impossible without such investment albeit, at the cost of economic dependence. Olopoenia (1983), explores the role of foreign capital inflow in the development processes of underdeveloped countries via its impact on savings. He fails, however, to reach unambiguous conclusion, contending that the effect of foreign investment on saving depends on the savings hypothesis used.

Additionally, Oseghae and Amenkhienan (1987), examines the relationship between oil exports, foreign borrowing and direct foreign investment in Nigeria, on the one hand, and the impact of these on sectoral performance, on the other hand. They surmise that foreign borrowing and FDI impacted negatively on overall GDP but positively on three main sectors (manufacturing, transport and communication, and finance and insurance).

Elsewhere, Olaniyi (1988) investigates the impact of direct foreign capital on domestic investment to ascertain its overall contribution to the enhancement of the domestic savings capacity in Nigeria. His model of domestic savings and investment financing in Nigeria empirically tested the impact of FDI on the level of domestic savings and investment. His results conform that domestic savings is by far more relevant in determining investment growth than foreign capital inflows in Nigeria. At best, the latter complements the former. This view has also been confirmed by the works of both Uremadu, (2006) and Adegbite and Owuallah, (2007).

Evidently, from the Nigerian studies reviewed so far, there seems to be a dearth of research explicitly devoted to the impact of foreign private investment neither on capital formation nor on the determinants of foreign private investment in the Nigerian scene proper thereby re-enforcing the need for this current effort.

With respect to the foreign studies surveyed earlier, it is apparent that, in general, empirical exploration of the determinants of foreign direct investment has not been definitive on what are the main factors. In particular, it is largely inexplicit what role the economic factors play relative to political factors. Curiously, the less than satisfactory state of research on this theme can be traced to issues of content and of statistical methodology. In relation to content, the studies show wide variance of economic and political factors used as arguments. And no convincing reason rooted in the theory is advanced for the inclusion or exclusion of particular variables (Chete, 1998). Thus, a drawback in most of these works is that their empirical estimation and the variables used as causal factors are not guided by theoretical considerations but mere *ad-hockey* as postulated in (Chete, 1998). The conclusion therefore is trite that the existing state of research shows serious conceptual and statistical weaknesses, providing further impetus for this study.

2.2 Theoretical Framework: A Review of Investment Theories²

Keynes (1936), pioneered the discovery of an independent investment in the economy, in contrast to, the widespread belief (that is, the Wicksellian loan market) that all available saving is automatically invested so far as the interest rate is attractive. Keynes' main contention was that investment is a function of the prospective marginal efficiency of capital relative to some interest rate which reflects the shadow cost of the invested funds. According to Keynes (1936), because of incomplete and uncertain information about private investment volatility in the future, potential investors would depend on their "animal spirits" in making their investment decisions rather than a rational calculation of an inherently intermediate distant future (Chete, 1998).

Investment theories that followed the tradition of the Harod Domar growth models emerged in the 1950s and 1960s. This was the precursor to the familiar accelerator theory. This theory posits investment as a linear function of changes in output derived from a fixed proportion of production technology. Thus, given an incremental capital-output ratio, it is easy to compute the investment requirements needed to achieve a given output growth target. In his model, profitability expectations and cost of capital considerations are ignored in the determination of investment.

The Neo Classical Approach to investment was next in line. Mainly spurred by the desire to obviate the shortcomings of the Harod Domar formulation, particularly in its simplistic assumptions, this approach introduces factor substitution in the derivation of the demand for capital from the firm's cost minimisation problems. Consequently, the desired capital stock is shown to depend on the rental cost of capital (which, in turn, depends on the price of capital goods, the real interest rate and the depreciation rate) and the level of output. This approach too has been attacked on account of inconsistency of the assumptions of perfect competition and exogenous output, the inappropriateness of static expectations and the introduction of delivery lags in an *ad hoc* manner.

Tobin's "Q" theory of investment of 1969 is an alternate formulation of the investment function. The theory postulates that the ratio of the market value of the existing stock of capital to its replacement cost (otherwise termed Q ratio) is the force driving investment. Tobin, subsequently elaborated two reasons why Q may differ from unity which include delivery lags and increasing marginal costs of investment.

Abel (1981) and Hayashi (1982), both, in separate studies, attempt a reconciliation of the Neo-Classical and Q approaches to investment. By showing that the latter follows from the firm's optimal capital accumulation problems under adjustment costs, they proved that what drives investment is marginal Q, that is, the ratio between the increase in the value of the firm due to the installation of an additional unit of capital and its replacement costs. However, marginal Q may not be observable as it will generally diverge from the observed average Q (which essentially is the market value of existing capital in terms of new capital), except under competitive equilibrium and constant returns to scale. Both will also diverge if firms confront quantity constraints in real asset or financial markets. In such a situation, average Q will, at best, provide some and not all of the information required to make investment decisions.

This disequilibrium approach to investment is associated with Malinvaud (1980, 1982) and Sneessens (1987). In this respect, investment is a function of both profitability and output demand considerations. Malinvaud (1982), splits investment decision into two stages: the decision to expand the level of productive capacity, and the decision about the capital intensity of that additional capacity. The latter depends on profitability variables like the relative cost of capital and labour. By contrast, the capacity decision relates to the degree of capacity utilisation in the economy as an indicator of demand conditions. In Sneessens (1987), net investment is a positive function of the gap between actual and long-run equilibrium capacities. This, in turn, is a reflection of differences between actual and equilibrium rates of capacity utilisation and between actual and equilibrium mark-up rates. Therefore, investment depends on both profitability (discrepancies between actual and equilibrium mark-up rates) and on sales constraints (discrepancies in rates of capacity utilisation). By implication, investment decisions may be reached in a setting in which some firms confront current and expected future sales constraints, a crucial departure from both the Neo-Classical (Jorgenson) and the Q (Tobin) models.

There exists an expanding literature on the effects of financial constraints on investment, for example, as seen in (Fazzari, Hubbard and Peterson, 1988a, 1988b; Caloris and Hubbard, 1989; Mayer, 1989 and Mackie and Mason, 1989). The central argument here is that internal finance (retained earnings) and external finance (bonds, equity or bank credit) are not perfect substitutes. The discrepancy in the cost of different sources of financing is due to asymmetric information where bankers in the capital market cannot evaluate accurately the quality of firm's investment opportunities; thereby leading to existence of opportunity cost of internal finance generated from cash flows and retained earnings. According to this view, investment will be very sensitive to financial factors such as the availability of internal finance or the access to capital markets (Chete, 1998).

Finally, another feature of investment in developing countries of sub-Saharan Africa (SSA) is the high import content of capital goods. This buttresses the contention in the two gap model (Chenery and Bruno, 1962 and Bacha, 1982), that the lack of foreign exchange may constitute a major constraint to sustain high rates of investment and growth in developing economies. Therefore in countries like Nigeria where domestic and foreign capital goods are highly complementary, the lack of foreign resource to import machinery and equipment will always constitute an impediment to growth. In other word, foreign exchange is a crucial determinant factor in capital formation among developing countries of Africa. This is a serious issue when viewed from the current perspective of our study.

3. Analytical Underpinning and Model Building

Here, we discuss analytical issues behind the model to be used in this study.

3.1 Analytical Issues

The decision to invest by an enterprise domiciled in an industrialised country in developing countries is often motivated by higher expected profits in comparison to the alternative investment possibilities at home or in other industrialised countries (Chete, 1998 and Olaniyi, 1988). The relative advantage of such investment is a function of both economic and political influences (Ogamba, 2003). Even if prevailing economic conditions seem favourable and the outlook for the future promising, it is entirely possible that investment may not materialise due to prevailing unstable political conditions. Hence, the need to consider foreign direct investment decisions which will impact on domestic capital formation would be brought into sharp focus in the present study.

There is therefore the need to briefly elucidate herein the analytical framework underlying the macroeconomic determinants of capital formation in a developing country like Nigeria taking a leaf from (Agarwal, 1980). This is carried out hereunder.

1. *Gross Fixed Capital Formation (GFCF)*

It is defined as an addition to stock of capital assets set aside for future productive endeavours in real sector which will lead to more growth in physical capital assets of the country. Capital formation captures all the real-value-added to the economy in real-asset-terms which will lead to further enhancement of savings, investment and generation of more wealth in future. Capital formation derives from savings accumulation. It has a positive impact on private savings accumulation in the sense that increase in capital formation will lead to more savings. When savings accumulate it will lead to an increase in gross domestic investment (GDI) and income generated as a result of the investment projects made will, in turn, lead to GDP growth (Uremadu, 2006).

2. *Cumulative Foreign Private Investment (CFPI)*

There is a growing consensus that an increase in cumulative foreign private investment, in addition to, inflow of foreign direct investment would complement domestic savings to meet investment needs in a particular LDC country (Olaniyi, 1988 and Uremadu, 2006). Expectedly, foreign investments should contribute to the development needs of the host economies hence substantial flows of CFPI are usually desired. Therefore the benefits derivable from CFPI is good but they neither substitute for the aids of official development assistance flows (Aremu, 1997). Thus, a high inflow of CFPI would lead to rise in gross domestic investment (which will, in turn, lead to growth).

3. *Gross National Savings (GNS)*

Drawing inferentially from (2) above, increases in gross domestic savings would lead to increases in gross domestic investment thereby engendering growth in the real sector. For CFPI to have desired positive impact on the capital formation for desired investment in a host country, the gross domestic savings must accumulate to a reasonable extent. This is one of the reasons why McKinnon (1973), hypothesizes that private investors in LDCs must accumulate money balances before undertaking projects because of limited access to credit and underdeveloped equity markets in the LDCs.

4. *Domestic Inflation Rate (INFR)*

A high rate of inflation is an indication that government lacks the ability to manage the economy (Fisher, 1993). Hence, high rates of inflation are expected to lead to a contraction of private investment. The empirical findings of Greene and Villannueva (1991), Oshikoya (1994) and Hadjimichael et al (1995) attest to the negative impact of high inflation rate on private investment in developing economies. Secondly, accelerating inflation rates impinge adversely on foreign investment activity by raising the risk of longer-term investment projects, lowering the average maturity of commercial bank loans, and distorting price signals in the economy. As a rule therefore, the higher the rate of inflation, the less are foreign investors inclined to engage in the country. A negative relationship is therefore hypothesised.

5. *Interest Rate on Lending or Maximum Lending Rate (MLR)*

A maximum lending rates (MLR) would raise the cost of capital and therefore dampens foreign private investment especially those requiring some infusion of domestic capital (Chete, 1998). Aremu (1997), stresses the need that the host country of foreign investment (either CFI or CFPI) should make credit available to domestic investors in form of subsidised loans, loan guarantees as well as guaranteed export credits. These credits are provided directly to both foreign and domestic investors for their operations particularly for the purpose of defraying some investible costs which invariably have an immediate impact on cash-flow and liquidity. Nigeria has instituted such facilities presently through the Bank of Industry (BOI).

6. *Foreign Exchange Rate (EXCHR)*

Obadan (1994) traces the importance of exchange rate on inflow of foreign private investment and notes that its importance as the centrepiece of the investment environment derives from the argument that a sustained exchange rate misalignment in terms of over-valuation or under-valuation, is a major source of macroeconomic disequilibria in developing countries. Consequently, an over-valued exchange rate or highly distorted foreign exchange rate will discourage exports and negatively affect foreign private investment environment.

The theoretical literature is ambiguous about the direction of the effect of real exchange rate on the rate of investment. On the one hand, a real depreciation raises the cost of imported capital goods, and since a large chunk of investment goods in developing countries is imported, domestic investment would be expected to fall on account of significant depreciation. On the other hand, a significant depreciation, by raising the profitability of activity in the tradable goods sector, would be expected to stimulate private investment in this sector but it depresses investment in the non-tradable goods sector. For low-income African countries, Oshikoya (1994), for instance *negative*, ascertains a *negative* impact of the real exchange rate on private investment. Chete and Akpokodje (1997) in Akpokodje (1998), also report a relationship between the real exchange rate and private investment in Nigeria.

7. *Index of Energy Consumption (INDEXEC)*

Pfeffermann and Madarassy (1992) identify, among other macroeconomic factors, that capacity utilisation relies much on efficiency of industrial or energy production, that are major determinans of foreign direct investment. They discover that the size of the domestic market and improved capacity utilisation are positively related to direct foreign investment, while inflation and volatile exchange rates have negative effects on foreign investment. Efficient infrastructural development proxied here by index of energy consumption (INDEXEC) will create conducive environment for high foreign private capital inflows and increased domestic investment. Hence, a positive relationship is hereby expected.

8. *Financial Intermediation proxied by Total Banking System Credit to the Economy (BSTCr)*

McKinnon (1973) and Shaw (1973) argue that financial deepening increases the rate of domestic savings, and this lowers the cost of borrowing and *Statistical*_stimulating investment. The core of this argument rests on the claim that developing countries suffer from financial repression. It posits therefore that the liberation of these countries from their repressive conditions would induce savings, investment and growth. In this view, investment is positively related to the real rate of interest, in contrast to, the neoclassical theory. The reason for this is that a rise in interest rate increases the volume of financial saving through the financial intermediaries and as such increases investible funds, a phenomenon that McKinnon (1973) calls the "conduct effect". Conceptually efficient financial intermediation allows a given amount of savings or bank credit to finance a greater amount of investment via efficient money creation by banks than could occur without intermediation (see Greenwood and Javanovic, 1990 and Uremadu, 2006). Recently the endogenous growth literature has also emphasised the important role that financial intermediation plays in improving the efficiency of investment (King and Levine, 1993).

9. *External Debt Burden Proxied by Debt Service Ratio (DSR)*

This is expressed by either debt service ratio (DSR) or the ratio of external debt to GDP. DSR is defined as the external debt services measured as ratio of actual debt services to total exports. The external debt burden negatively impacts on savings and CFPI. A higher ratio of external debt to GDP, indicates that the country is experiencing a large debt "overhang" and this discourages savings and gross domestic investment or capital formation. The reason is that a significant portion of future returns from investment will be used to repay current debt obligations. Similarly, if huge debts cause difficulties in meeting debt service obligations, relations with external creditors may deteriorate thereby inducing a cut-back (in) to resource inflow into the country. Therefore DSR impacts negatively on capital formation.

3.2 Model Specification, Data Requirements and Estimation Methods

We shall adapt Chete (1998)'s model which equally emanates from the foregoing analytical considerations of the study. It is stated as follows:

$$\text{GFCF} = f(\text{GNS}, \text{CFPI}, \text{INFR}, \text{MLR}, \text{EXCHR}, \text{INDEXEC}, \text{BSTCr}, \text{DSR}) \quad 3.1$$

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Hence, the multivariate specification of the equation for estimation in our model is as follows:

$$\text{GFCF} = b_0 + b_1\text{GNS} + b_2\text{CFPI} - b_3\text{INFR} - b_4\text{MLR} - b_5\text{EXCHR} + b_6\text{INDEXEC} + b_7\text{BSTCr} - b_8\text{DSR} + e \quad 3.2$$

where:

GFCF = gross fixed capital formation as % of GDP
 GNS = gross national savings as % of GDP
 CFPI = cumulative foreign private investment
 INFR = domestic inflation rate
 MLR = maximum lending rate
 EXCHR = foreign exchange rate expressed as naira per \$1 US dollar
 INDEXEC = index of energy supply expressed in tonnes
 BSTCr = total banking system credit to domestic economy as % of GDP
 DSR = debt service ratio (%)
 e = random error term

3.3 Data Source

Data for the study were sourced from *World Bank Database* (various, *CBN Bulletin* Vol. 15 (Dec. 2004) and *Annual Report and Statement of Accounts* (Various) which spans the period 1980-2004. These were supplemented with data from the Federal Ministry of Mines, Power and Steel, Nigerian National Petroleum Corporation, National Electric Power Authority.

3.4 The Concept of Cointegration³

The task in empirical study based on the error correction methodology is to ascertain if there is a static long-run equilibrium relationship as suggested by theory and subsequently derive on adequate dynamic modelling of the short-run relationships (Chete, 1998). Hence, the emphasis on the existence of long-run equilibrium relationships implies that in any empirical enquiry, a useful starting point is to conduct a specification search to ascertain that there exists an equilibrium relationships among the levels of the variables in the model. To Granger (1986), co-integration is the statistical equivalence of the economic theoretical notion of stable long-run equilibrium. Consequently, co-integration is a useful approach in this perspective. The existence of the concept among the variables of the model provides somewhat conclusive evidence on the existence of stable equilibrium relationships among them. Inferentially the variables have a common trend and would not drift far apart for long.

Co-integration is based on the properties of the residuals from regression analyses when the series are individually non-stationary. A series is stationary if it has a constant mean and constant finite variance. Thus a time series X_t is stationary if its mean $E(X_t)$ is independent of time and its variance, $E[X_t - E(X_t)]$ is bounded by some finite number and does not vary systematically with time. It tends to return to its mean with the fluctuation around its mean having a constant amplitude. In contrast, a non-stationary series has a time varying mean (or variance) and cannot normally be referred to without reference to some particular time period. Non-stationary series are referred to as integrated variables.

A series X_t is said to be integrated of order d , denoted $X_t-I(d)$, if it must be differenced d times before it becomes stationary. Series X_t is $I(d)$ if it is non-stationary but dX_t is stationary. A stationary series is thus integrated of order zero, $I(0)$, while a $I(2)$ series will need to be differenced twice to become stationary and so on. $I(0)$ series will usually return to the mean often while $I(1)$ series will rarely return to any particular value, including its starting value. Most macro-economic variables seem to be $I(1)$, a few are $I(0)$ and a few are integrated of orders higher than 1.

Testing for co-integration is parallel to testing for the stationarity of the residuals from a linear regression of the vector of non-stationary time series. It is necessary that co-integration tests to be preceded with tests for the orders of integration of the individual series in the vector. Similar tests are used for stationarity of the residuals from the OLS regression and time series variables.

The Dickey-Fuller (DF) and the Augmented Dickey-Fuller (ADF) statistics and the Sargan Bargava Durbin Watson (DW) statistics are the three most commonly used tests for stationarity for both individual time series, and residuals from OLS regression.

The ADF test is based on the following regression:

$$\Delta X_t = b_0 + b_1 \Delta X_{t-1} + b_2 \Delta X_{t-2} + \dots + b_n \Delta X_{t-n} + e_t \quad 3.3$$

where (e) is a stationary error term. The null hypothesis that X_t is non-stationary is rejected if b_1 is significantly negative. The number of lags (n) of ΔX_t is usually chosen to ensure that the regression is approximately white noise. It is simply referred to as the DF test if no such lags are

required in which case $b_i=0(i=1,2,...,n)$. However, the "t-ratio" from the regression does not have a limiting normal distribution. It follows the Dickey Fuller distribution, the critical values of which are available in the Computer Microfit 3.0 software.

The Sargan Bhargava Durbin Watson (SBDW) test (after Sargan and Bhargava, 1983), is based on the variable itself when applied to individual time series, and not on the residuals as in the Standard Durbin Watson test in regression analysis. The null is that the series is $I(0)$. SBDW would then be expected to tend towards 2. A low value close to zero is indicative of non-stationarity.

In testing for co-integration, therefore, the same tests are employed but the series of the tested are the residuals from the OLS regression. The null of non-cointegration being that the residuals are non-cointegrated. The "t-ratio" for the Dickey Fuller-test follows an Engle-Granger distribution rather than the Dickey-Fuller distribution. The critical value for this is also now available in Microfit 3.0.

3.5 Data Nature and Characteristics

Following are data employed in this analysis:

1. GFCF=gross fixed capital formation as a (% of GDP). GFCF is mirror of gross domestic investment in Nigeria.
2. GNS=gross national savings as a (% of GDP). GNS is proxy for total savings/GDP ratio at current market prices ratio. It is the total institutional savings mobilised by both private and public sector financial institutions in the country. Positive impact is expected.
3. CFPI=cumulative foreign private investment in Nigeria as (% of GDP). It is mirror of foreign private investment in Nigeria. Positive impact is expected.
4. INFR=domestic inflation rate (%), defined as the annual percentage change in the CPI.
5. MLR=maximum lending rate (%), the rate at which the small business entrepreneurs borrow in Nigeria. Negative impact is thus expected
6. EXCHR= monthly average official exchange rate of naira vis-à-vis the United States Dollar (N,=/\$1.00) computed into annualised value. Negative impact is therefore expected.
7. INDEXEC= Index of energy consumption (tonnes of coal equivalent) (1985 =100). Positive impact is expected in this case.
8. BSTCr= total banking system credit (ie. total demand deposit liabilities plus banking system investments) to the national economy
Positive impact is also expected.
9. DSR= ratio of debt servicing to total exports, defined as the external Debt services measured as ratio of actual debt services to total exports. Negative impact is expected here.

4. Model Estimation and Interpretation of Results

4.1 Presentation and Analysis of Results of Stationary Tests

Tests for the stationarity of the variables are presented in Table 1 below. For the ADF statistics (the 95% critical values are shown after each t-statistic at next column), the null of non-

stationarity is accepted if the reported statistic is greater than (One Tail Test) the critical values. The results shows that when expressed in levels, four of the variables are non-stationary (MLR, INDEXEC, BSTCr, DSR) and four, are stationary (GNS, CFPI, INFR, EXCHR). Differencing once however induced stationarity in three (MLR, INDEXEC, DSR) while BSTCr was differenced twice before it attained stationarity.

Table 1: Unit Root Test Results for Stationarity(at various levels)

| Variable | DF | ADF (Test Critical Values) | t-Statistic | P- Values | Order of Interpretation |
|-------------------------|----------|----------------------------------|-------------|--------------|----------------------------|
| C | 1% 5% | -3.752946** -2.998064*** | -4.264501 | 0.0031 | I(0) |
| Δ GNS | 5% | -3.065585*** | -3.880203 | 0.0108 | I(0) |
| Δ CFPI | 5% | -3.73853 | -1.544395 | 0.4946 | I(0) |
| Δ INFR | 10% | -2.635542***** | -2.764418 | 0.0784 | I(0) |
| Δ MLR(1) | 1% 5% | -3.752946** -2.998064*** | -9.192626 | 0.0000 | I(1) |
| Δ EXCHR | 1% 5% | -3.886751 -3.052169 | 0.623647 | 0.9858 | I(0) |
| Δ INDEXEC (1) | 1% 5% | -3.752946** -2.998064*** | -5.193765 | 0.0004 | I(1) |
| Δ BSTCr (2) | 10% | -2.638752***** | -2.726706 | 0.0849 | I(2) |
| Δ DSR (1) | 10% | -2.650413***** | -2.983390 | 0.0537 | I(1) |

Source: Author's Calculation

Key: *MacKinnon (1996) one-sided p-values

**Significant at 1%

***Significant at 5%

****Significant at 10%

To determine if there is a co-integrating relationship between the independent variables, the model was estimated with the variables at their levels. The residuals from the regression were tested for stationarity using ADF test. The residuals were found to be stationary indicating the existence of a co-integrating relationship. Using the MacKinnon (1996) critical values for co-integration test, we reject the null hypothesis of no co-integration and conclude that the variables are co-integrated at 5% level of significance. This motivated the development of an OLS regression model with an inbuilt (e), the random error term. Specifically, we used the E-Views Computer package for the purpose of our programming which yielded results for the regression coefficients and associated statistics.

4.2 Analysis of Regression Results

After normalising the structural equation on change in GFCF in vector autoregression of the current and lagged first differenced of all the variables, and then starting with an over-parameterised model based on the general-to-specific methodology, regression analysis was conducted. Table 2 is the empirical results for the OLS modelling of determinants of capital formation in Nigeria.

Table 2: Modelling: GFCF Function by OLS

| Variable | Coefficien t | Stad. Error | t-Statistic | Prob. |
|------------------------------------|-----------------|----------------|-------------|--------|
| b ₀ (Constant) | 9.232819 | 8.423148 | 1.096125 | 0.2915 |
| GNS | -0.060633 | 0.098048 | -0.618398 | 0.5462 |
| CFPI | 0.009660 | 0.387160 | 0.024950 | 0.9804 |
| INFR | -0.030202 | 0.038851 | -0.777378 | 0.4499 |
| MLR(1) | -0.166878 | 0.219533 | -0.760149 | 0.4598 |
| EXCHR | -0.105467 | 0.03.651 | -3.440893* | 0.0040 |
| INDEXEC(1) | 0.096731 | 0.037896 | 2.557522** | 0.0230 |
| BSTCr (2) | 0.044344 | 0.148359 | 0.298900 | 0.7694 |
| DSR (1) | -0.139496 | 0.059433 | -2.347087** | 0.0342 |
| R ² = 0.763336 | | 76.33% | | |
| R ² Adjusted = 0.628100 | | 62.81% | | |
| DW Stat = 1.639969 | | 1.64 | | |
| F-Statistics = 5.644464 | | 5.644464 | | |
| Sum squared resid = 140.9570 | | 140.9570 | | |
| S.E of regression = 3.173067 | | 3.173067 | | |
| Prob(F-Stat) = 0.002496 | | 0.002496 | | |

Source: Author's Calculation

Key: *Significant at 1% level

**Significant at 5% level

A close inspection of the results shows that foreign exchange rate had the most significant and negative impact on capital formation and therefore lead gross domestic investment, followed by index of energy consumption and then, debt service ratio (both at 5% levels of significant). Results also reveal that all the variables except one, gross national savings, maintained right direction of sign. In general, the descriptive statistics for this model (R², F-Stat and DW-Stat) are within acceptable bounds. Further, the results of the diagnostic tests indicate the absence of error of auto-correlation and conditional heteroscedasticity as value of DW test is tending to 2, hence the errors are normally distributed.

Specifically, the negative sign and insignificant impact of gross national savings coefficient on capital formation is very instructive. The negative effect suggests that cumulative foreign private investment (CFPI) in real terms has crowded out gross domestic savings since the latter is so low and distorted that it cannot positively and significantly impact on capital formation (CF) or gross

domestic investment (GDI) as at its present low status profile. Gross national savings (GNS) low rating has not formed a good base to attract more cumulative foreign private investments into the country to adequately complement savings in order to raise domestic capital formation. Hence, inadequate cumulative foreign private investment results and the size of both gross national

savings and cumulative foreign private investment as they presently stand in Nigeria cannot make the desired significant impact on capital formation. Nigeria's gross national saving rate does not command good leverage to attract adequate cumulative foreign private investments into the national economy. However, CFPI is correctly signed is suggestive that higher cumulative foreign private investment induces greater capital formation.

Capital formation is also sensitive to the domestic inflation rate, and external debt burden proxied by debt service ratio (DSR). The negative coefficient on inflation rate and high negative coefficient on debt service ratio indicate that accelerating inflation and huge debt overhang are serious disincentive to raising high gross domestic product or capital formation for the national economy.

Similarly, the coefficient of the level of maximum lending rate is also correctly signed indicating that high rate of interest on lending or banking system credit to the domestic economy discourages capital formation growth for the national economy. On the other hand, total banking system credit to the domestic economy exhibited positive and insignificant impact on capital formation growth supporting the argument that increasing banking system credit to the domestic economy would boost gross domestic investments gross or capital formation (GDI).

The coefficient of the level of foreign exchange rate (EXCHR) on capital formation (CF) is correctly signed. High EXCHR exhibits negative impact on capital formation. The international real exchange rate is inversely related to CF giving support to the thesis that rise in real cost of imported capital goods engendered by escalating real exchange rate would tend to dampen domestic capital formation. This, in turn, will decrease GDP. But lower exchange rate will make possible importation of huge industrial goods and raw materials will raise production of productive goods which will raise increase capital formation in real terms.

Finally, the coefficient of the level of index of energy consumption is also significant and correctly signed suggesting that increased supply of energy induces greater capital formation or gross domestic product (GDI). Energy is vital to the working production of real industrial goods, hence it exhibited a positive and significant impact on CF or GDI.

5. Discussion of Findings, Recommendations and Conclusion

5.1 Discussion of Findings

A set of policy lessons can be deduced from the results reported in the preceding section, chief among which is the need to moderate, through a combination of a carefully thought out and assiduously implemented monetary and fiscal policies, the rate of foreign exchange. The relative impact of exchange rate alignment in inducing foreign capital inflow and in discouraging same by triggering or exacerbating inflation cannot be undermined. Depending on which dominates the other, the effect of exchange rate depreciation on foreign private investment and by extension, on gross domestic investment which is capital formation would have been clarified. This is in line with (Chete, 1998). Results of the empirical analysis outstandingly revealed that exchange rate variable leads capital formation in Nigeria and it maintains its expected negative sign. It is so because of the following reasons: (1) we import significant portion of virtually all our inputs that go into real goods manufacturing or physical industrial goods production. (2) Our source of generating foreign exchange is oil, Nigeria being a mono-product or rentier economy and (3) virtually all the machinery that go into our industrial production or process is imported.

Secondly, the need to raise volume of energy consumed by Nigerian industries comes to the fore. Index of energy consumption proxied by index of industrial production is very critical to our productive sector or environment in abide to raise gross domestic investment or capital formation. Energy infrastructure, power, capacity utilisation and all worth not that matter in

boosting capital formation for the domestic economy are very critical to our industrial growth. Hence, index of energy consumption impacts positively and significantly on quantum of capital formation formed or achieved in Nigeria.

Third, the negative sign and significant impact of debt service ratio (DSR) on capital formation as evidenced by the results from our regression analysis, portrayed that external debt burden is a very strong disincentive to capital formation growth in Nigeria. Money that would have been used to inject into production of new physical capital assets (goods) which aid productive activity is now being used to service foreign debts. Huge debt service payments will always reduce capital formation in a developing economy like Nigeria.

Finally, the negative and insignificant impact of gross national savings (GNS) in impacting on capital formation has the plausible reason that we have not mobilised enough domestic savings that will attract desired foreign private investment into the country which will complement gross national savings to positively and significantly influence capital formation. CFPI, though, has positive effect on CF is not yet enough to raise capital formation in Nigeria.

5.2 Recommendations and Conclusion

Based on the findings of this research which have been above stated and implications emanating there from, we therefore proffer the following matching recommendations put down hereunder for urgent policy action:

1. That efforts should be geared by government to reduce exchange rate distortions and or misalignment, increase export of locally manufactured goods and raw materials in a bid to raise value of the local currency, the naira; earn more foreign exchange and allow market forces to properly fix exchange rate. This policy thrust will most likely result into increased capital formation in Nigeria needed for our real sector investments and industrial growth.
2. The policy recommendation with respect to our number two findings is that to optimally raise the level of capital formation in Nigeria, government has to maintain a steady supply of energy (power) and other infrastructural supplies. We cannot raise gross domestic investment (i.e. capital formation) and national productivity level without maintaining adequate supply of energy to all facets of our industrial machinery.
3. Thirdly, we thus recommend continuous minimisation of foreign debts to reduce amount of national income used for debt servicing so as to invest greater proportion of our annual national income into productive capital goods that will raise capital formation to boost GDP.
4. The paper therefore finally recommends that adequate efforts be made to mobilise desired gross national savings which would be big enough to attract direct foreign private investment that will complement domestic savings towards rising capital formation to a level needed for industrial growth and development that will raise GDP growth in Nigeria.

In concluding this paper, we make quick to say that these above recommended views are the right policy action goals to pursue in these times in Nigeria by the government and or monetary authorities to raise our desired gross domestic investment (GDI) or rather the capital formation (CF) in our country. These are our convinced conclusions in this 21st century emerging Nigerian economy.

Notes

1. Work profited elaborately from L.N. Chete (1998)'s "Determinants of Foreign Direct Investment in Nigeria". *NISER MONOGRAPH SERIES* No. 7
2. Same as reported in (1) above.
3. The exposition in this section benefited elaborately from L.N. Chete's treatise of the

concept of cointegration.

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CONTROVERCY IN THE EVOLUTION OF THE WORLD AND EUROPEAN FINANCIAL REGULATION

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Abstract

The financial regulation structures are linked to traditions and differ from one country to another. The financial revolution, and in Europe, the creation of unique market of the financial services launched again debates over the suitability of the regulation structures.

5-10 years ago, the debates were quartered over the virtues, especially on the disadvantages that the self-regulation system shows vs. the regulation practiced by the public organisms within the law provisions. The debate is based now on types of problems: the role of the central bank and the problem of the specialization.

Regarding the role of the central bank, there are arguments if the central bank is the proper authority to supervise banking and act in accordance with it, as a councilor, after all.

Regarding the specialization, there are arguments if a super or hiper authority, authorized to regulate all the types of services and financial institutions is more adequate than the regulation by specialized agencies.

At the level of the European Union, there is an extra problem if the national authorities must keep the prerogative of financial services supervision, however in accordance with the basic principle of the economic and monetary integration, or if, on the contrary, it is better to form a European supervision authority for the financial services.

Key words: globalization; financial regulation; financial supervision; financial markets efficiency, financial conglomerates.

1. Regulation structures at the global level

At the level of status, action and institutional construction, England played a pioneer role, when in 1997 Tony Blair's Labor Party created the Financial Services Authority, as a unique financial services regulation authority, stating also the role of the Central Bank in banking supervision (by exonerating the English Bank of this prerogative) and also the virtues, especially the defaults of the unique regulation towards the specialized regulation.

Austria, Denmark and Sweden also have unique regulation authority. Two countries – Belgium and Finland – have joint organisms for banks and investment services; other seven countries have separated institutions, which regulate the investment services. In France, the main regulation organism is the Committee for Stock Exchange Operations, the so-called COB, which shares responsibility with other two organisms: The Financial Market Council, a regulation organism, which supervises market transactions and The Banking Committee, which supervises the banking activity. Germany, which at present has special authorities for banking, investment services, insurance, expressed its wishes to adopt the unique regulation authority system. In France, too, there are talks to merge the regulation authorities, but the French authorities sustain firmly the heads regulation model, respectively for the circumspection regulations and wholesale (professional financial transactions) and the retail market regulations, on which the financial products are sold to the consumers.

Among the European Union countries, Hungary was the first, in the first part of 2001, to proceed to the merging of the three regulation agencies within the Hungarian Financial Supervision Authority.

Outside Europe, there are regulation and supervision super authorities in Japan, South Korea, China, Hong Kong, Taiwan, and in North America - Canada.

In the USA, the regulation system, which has not changed essentially since 1934, is characterized by specialization and fragmentation. The capital markets are regulated by SEC (Security and Exchange Commission). But the other components of the financial services sector are under the authority of more regulation and supervision state bodies. The so-called Office of The Comptroller of The Currency is the one that watches over banks, but also The Federal Deposit Insurance Corporation, The Federal Reserve Board (The Central Bank) and The Bank Boards from different states. As for the insurance companies, they are regulated and supervised by the states insurance Boards.

2. The central bank and the banking supervision

According Karel Lannoo (1998) from the Brussels European Centre of Political Studies (CEPS), the debate this problem should be started from the role of the central bank in insuring the stability of the financial systems and prevention of the contagious systemic crisis.

The pro argument: the practicing of the regulation and banking supervision functions by the central bank can contribute to the general financial stability insurance, inclusively in the process of bank saving.

The con argument: the monetary policy and banking supervision functions generate interest conflicts, endangering the price stability and stressing the moral risk.

Both regimes are equally illustrated in the European Union. According to Goodhaad and Schoenmaker (1995), the matter must be regarded not as an abstract theoretical exercise, but in the context of financial structure and banking particularity from each country. An analysis of the bankruptcies from the last two decades shows a more frequency in countries with a separate regime, than in the ones with mixed regimes. Their conclusion is that the banking saving operations are more likely to happen in mixed regimes.

In the banking sector there is an increase in the role of the self regulation, and there would be an over increasing agreement on the idea that the government and not the central bank, should bear the responsibility of the financial support in extreme cases. This is the case of the last decade experiments in Norway, Sweden and France, because they turned to the public fund financing, transferred to the taxpayer.

3. Two visions over the financial markets regulations

We consider that the approaches of the regulation problems group around two concepts:

- I. The efficiency of the financial markets and
- II. The imperfection and the instability of the financial markets (Plihon, 2001), concentrated in the following table.

| | 1st paradigm: The efficiency of the financial markets | 2nd paradigm: The imperfection and the instability of the financial markets |
|-------------------------------------|--|--|
| The place of the public supervision | Supervision must be limited to following the transparency rules. Public supervision must be constrained if it affects the market discipline play. The disfunctions of the market come mostly | Supervision is a necessary completion of the market discipline. The need to interfere from the outside of the market. Public supervision is necessary to |

| | | |
|------------------------------|---|---|
| | from the excess than from the insufficiency of the public supervision. | compensate for the markets failure. |
| The market discipline | <p>The market discipline must be the main way to regulate markets.</p> <p>All obstacles that alter the market discipline play must be eliminated.</p> <p>Grants and public warranties.</p> <p>Deposits insurance must be limited to monetary deposits.</p> <p>The development of the subordinated debt.</p> <p>The financial freedom of the emerged countries must be simulated.</p> | <p>The market discipline is a necessary condition, but not enough for the proper function of the markets.</p> <p>The market discipline must be completed by:</p> <ul style="list-style-type: none"> – penalties from the regulation authorities; – early correction actions. <p>Financial freedom of the merged countries must be followed by the construction of an effective public supervision system.</p> |
| The role of the transparency | <p>Transparency, the necessary and sufficient condition for the market discipline exercise and for the informational efficiency of the markets.</p> <p>The need that the necessity to information to be expanded to all the participants – banking or non-banking – at the financial markets. The financial crises from the emergent countries are due to the lack of transparency of the local financial institutions.</p> | <p>The following of the regulation rules is not sufficient:</p> <ul style="list-style-type: none"> – the opacity – the fundamental characteristic of the banking agency - imposes public supervision; – the exclusive accent on transparency ignores the mimesis and other compartments on resulted from the collective psychology of the financial markets. |

We must keep in mind that the financial regulation entails three functions:

- the behaviour rule setting;
- the control of the rule application (monitoring);
- the cautious supervision, whose objective is risk prevention.

The financial regulation and supervision have a caution micro dimension (the authorisation of the public financial services performing; supervision according to the continuous report documents and on the spot control) and a new macro cautious dimension, regarding prevention and crises fight (risk limitation and insurance of good protection against them).

4. Supervision authority through consolidated regulation or through special regulation?

The arguments of the scale economies, some political and practical advantages and especially the fact that this kind of regulation is the best adjusted to the financial conglomerate forming tendencies, offering the entire range of financial services and products plead in favour of the consolidated regulations.

| Pro arguments | |
|--|--|
| A unique authority of financial regulation | An authority of financial regulation |
| -one-stop measure in order to authorise | -easier organization |
| -expertise concentration and scale economies (e.g. by merging the authorisation functions) | -clearly defined competences |
| -lower supervision costs | -closer to regulation activities |
| -more adjusted to the financial sector evolution by financial conglomeration | -more adjusted to the differences regarding the risk and the nature of the financial activities, a more clear focus for the objectives and the regulation good sense |

| | |
|---|---|
| -cooperation insured by the supervision forms: a coordinator for the conglomerate supervision | -a better knowledge of the regulation activities |
| -the absence of the arbitration need regarding the regulation | -a more discreet presence |
| -a more transparent form for the consumer | -a bigger tendency towards the objective based tendency |

Source: Karel Lanno

The objective basis supervision. A way to adjust to the forming of conglomerates tendency is as supervision to become more focused on objectives and to proceed separately on matters regarding:

- stability, solvency;
- business behaviour: informing and transparency, practice based on honesty and fair-play, equality of the market participants.

5. The financial regulation problem at the European Union level

The creation of a unique financial services market is supported by three pillars:

- a minimum homogeneity of the different national markets as an affect of the European regulation provision implementation regarding banking, financial investment services and insurances, able to allow the mutual recognition of the tools, of the financial services and of such services providers;
- “unique passport” principle, meaning the viability of the offered authorization in a country to establish subsidiaries in any member country or to provide trans border services;
- responsibility of the host country regarding supervision.

The commission, reacting at the member countries disobedience, set a Forum of the Transferable Securities European Committee (FESCO) with the mission of promoting cooperation among the regulation authorities for the transferable securities markets.

FRESCO doesn't have the official status, but must work in accordance with a consensus, and cannot issue compulsory recommendations. Therefore, soon after the euro was released, the European leaders adopted, at the Lisbon summit from Mars, 2000, the Action Plan for the financial services (FSAP) initiated by the Commission, which recommended 42 measures in order to rationalize the wholesales and retail financial markets, with implementation terms up to 2005, whose achievement elongated to 2007.

The present points of view are the following:

Most of the member states agree with the idea of a unique regulation forum, others, as France, support an integrated system, but a dual one. In accordance with the same considerations, the idea of a pan European regulation forum is regarded as a solution for the present chaos from this field. Other countries continue to prefer the national authority and competition system between different jurisdictions.

The Lamfalussy group, the President of the Wise Men Committee over the transferable securities European markets regulations identified numerous and important **gaps** in the European laws and proposed a series of priory measures, which were adopted and came into force at the end of 2003:

- a unique prospect for the issuers, with an obligatory preliminary registration system;
- the modernising of the demands to subscribe for the share and the introduction of a clear distinction between the share admission and the transaction admission;

- the generalization of the mutual recognition principle for the wholesale markets, including an accurate definition of the professional investor;
- the modernizing and the development of the financial investment rules for the investment funds and pension funds;
- the IAS adoption (international accountancy standards);
- the unique passport for the confirmed stock markets and the application of the principle that supervision is assured by the host country.

The Lamfalussy group noticed that in the European Union there are about 40 public organisms which deal with the supervision and the regulation of the transferable securities markets. The components are mixed and the responsibilities are different. They sum up that **“The result at the European level is the fragmentation and, often, the confusion”**.

6. The unification of the financial services regulation and supervision in Romania

The distinction between the wholesale and retail markets, supported by France and applied in Italy, is considered to be fertile and could be kept in consideration in a later stage of evolution in the Romanian capital markets, if the situation asks. But for the moment, the way to England should be kept open and should be followed in our area by Hungary. Unitary standards application and setting would create better conditions for the financial services evolution and a more effective supervision achievement.

7. The impetuous evolution of the financial research

The profound transformations of the financial markets in the last two decades, has as a major feature the fact that one of its pillars was made by the passing through achieved at the theoretical level at which a series of well-known economists and money specialists, some of them being awarded with the Nobel Prize for economics.

The diversity of the financial assets and the risk reduction while the title portfolio is increasing are linked to Harry Markowitz contributions, starting with the Ph. D. work in 1952. For these contributions, which revolutionized the way and the management practices of the individual and institutional portfolios, he was awarded with the Nobel Prize for economics in 1990.

The arbitration technique derived advantages from Franco Modigliani and Marton Miller's important contributions. They proved that the market value of a company is independent of the way in which the company finances its capital and takes place especially from the cash flow. A company in great debts, but also with an important cash flow can have a greater value on the market than a company that shows precaution when it comes to reference to external resources and debts.

Modigliani and Miller are the founders of a new economic-financial subject, appeared at the junction between the pure economic theory and the financial conduct of the companies. At the practical level, their contributions stand at the basis of the action of the investment companies, which follow earnings from the arbitration operations.

The passive administration based on financial title portfolio subscripts is based on the effectiveness **theory of the capital markets**.

Ragan and Zingales (1998) focus on **the techniques by which the financial development stimulates the economic growth**. They test empirically the idea that under the conditions of some evolved financial systems the companies and the branches, which depend on financing by attracted means, are advantageous (new companies and branches).

Their conclusion is that the former previous evolution of the capital markets facilitates in a great amount their former post growth of these companies and branches. As they are a source of new ideas, the financial evolution stimulates the innovation and therefore the economic growth. They demonstrate especially the importance for a development growth of the risk capital market.

Therefore, we can conclude that a very developed capital market represents for a country a comparative source of evolution in branches, which are more dependent on an external financing.

Levine and Zervos also **check** empirically **if the development levels of the stock markets** (liquidity, dimension, volatility and integration with the world capital markets) **are correlated with the ratio presented in the next economic growth, capital accumulation, and productivity and saving ratio growth.** They analyze the statistics from 47 countries from 1976 to 1993. Their conclusion shows that these correlations are positive and important. The financial factors appear as an integrant part of the growth process.

In 2000, a study developed by three economists analyzes data from 63 countries regarding the period 1960-1995, in order to depict **the influence of the financial development over the economic growth and over its sources.** They follow the influence of this type of development over the saving ratio, the cash capital accumulation and the total increase of the productivity at the factor level. These authors do not notice a strong positive correlation with the cash capital accumulation or the private saving ratio, but find such a correlation when it comes to the real increase of the GNP on inhabitant and the productivity increase at the factor level.

Conclusions

The financial supervision authority although evolved plans: consolidate regulation and special regulation, it still wins a lot: the idea we are supporting of objectives based supervision (e.g. stability, solvability, business conduct etc.). Within the EU the existence of a large number of regulation and supervision organisms led to the conclusion of fragmentation and sometimes confusion.

The strong development of financial power research based on mechanisms by which the financial evolution stimulates the economic growth and financing sources has won a lot.

April 2008

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THE EFFECTS OF INFORMATION TECHNOLOGIES IN MARKETING

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Abstract

At 1990's the computers and internet had been used particularly by governments and universities. And this had started deep-rooted changes in the life of humans. This period has been called as the age of information. In this time the basis properties of the life has not been changed but new properties have been added to their ways. Continuously regeneration of information technologies has produced information systems. Information systems are the rule series that decide the data which one will select and how it will process. The development in the information technologies caused big exchanges in the structure of organization and affected all operations of business. Communication, selling and buying, obtaining information, marketing and advertising, management, health, logistics, banking have been getting new formats by information technologies. In this study the effects of IT have been inspected over marketing. IT affected the marketing both Marketing Information Systems that support all marketing operations of business and diversifying the marketing process. We aimed to inspect these two main effects in our study.

Introduction

The developments in the information and communication technologies have brought a lot of novelty and accelerated the present processes. Information technologies affected the organizations' work styles. The economic and social affects of this changes caused big exchanges in the structure of organization. The organizations that want to subsist, invested in information technologies and so they rendered their work styles compatible with information technologies. The exchanges have not confined with these and they have directed organizations to investments in updating, refreshing and reclamation hardware and software. Investments of organizations have rendered organization structure more flat, increased the number of employees and bureaucratic works and felt down the costs of communication, formation and saving documents. It has also been used from the undermost management level to uppermost level and supports all management levels in decision making. It has offered flexibility to the organizations which prefer central or local management and affected the organization control, communication, authority mechanism and decision making process. The IT which is used in all management levels, has been a strategic tool for business world nowadays. Information technologies contribute to organizations' basis and champion functions as marketing, logistic, selling, offering service, buying, human resource, management. It has also strengthened the value chain between organizations, customers and providers. All management levels effected from information technologies. With this new information stage, organizations have to change their marketing actions.

The marketing action of organizations begins with a well appointed market, focuses with customer needs, and coordinates all actions for reaching the customer and by satisfying him it gains. Also it includes advertising, actions before and after selling, improving long-term relations with customers...e.g.¹. In the digital era, a new market place has appeared which it would be accessed 7/24 and the competition has been very intensive. Now the market place and the customer are not just the same; new treatments, continuously growing competition, challenges have been the special properties of the new market. Modern marketing has been formed customer focused by the effects of globalization and information technologies. In the information technologies there is a continuously change on the customer's habits, expectations and needs. The customers have been able to access to all market and they move all the time. Their sensitivities of the prices have been increased so they want more qualified, faster and cheaper products and service. Also they think the differences between the products have been decreased so their brand constancy has decreased. Now the customer doesn't search the only suitable product, he wants the most suitable product and he can find it on the internet and in other information sources. IT affected the marketing both Marketing Information Systems that support all marketing operations of business and diversifying the marketing process. We aimed to inspect these two main effects in our study.

Marketing Information Systems

Marketing Information Systems are computer-based systems that work in conjunction with other functional information systems to support the firm's management in solving problems that relate to marketing the firm's products. They have been used to collect information for marketing actions, analyses and present them to the marketing manager for making effective decisions. Marketing Information Systems are help systems that can be used to product strategic, operational and tactical decisions for the marketing management. They collect information for the level of demand, properties of demand and the effect of its components. Also they are set up by the upper level of management to learn changes of the demand, new enterprises of rivals and new distribution channels. The first definition of Marketing Information Systems was given by Cox and Good². A MIS can be thought as a set of procedures and methods for the analysis and presentation of information that is to be used in decision-making. MIS are used to support the planning and control operations. Most of the resources of MIS are consumed to support decisions related with the prices and the products. O'Brien says that the MIS are an effective tool for the conversion of row data into useful information. Statistical analysis software, logic programming languages, and expert systems shells are only used occasionally³. Nylén defines marketing information systems as interactive systems consisting of procedures and methods that systematically handle the collection and process of information and the generation of reports in order to support the marketing decision-making. According to Marshall and LaMotte marketing information systems like a comprehensive and flexible, formal and ongoing system designed to provide an organized flow of relevant information to guide marketing decision making. Marketing information system is implementation of information. It contains management of information, application of information, process of new product, easier communication with customers, and using information for solving problems during management and marketing operations⁴. Marketing

¹ Karafakioğlu M., UluslarArası Pazarlama, p.11

² Cox D.F., God R.E., "How To Build A Marketing Information System", Vol.45, N.3, p. 145-154

³ Li, E.Y. (1997), "Marketing Information Systems In Small Companies", Information Resources Management Journal, Winter, 10,p.27

⁴ Barutçugil, O., "*Bilgi Yönetimi*", Kariyer Yayınları, İstanbul,s.142

information system may contain MIS, DSS or ES subsystems. As figure 1 the MIS, collects information from the inside and the outside of the organization and appreciates, corrects, saves this information with subsystems. At the last step it presents information to concerned management level with output systems.

Marketing information system has subsystems and it has been enlarged with these systems. The figure 2 shows the management information system and its subsystems.

Input subsystems collect data from internal and environmental sources for databases. Accounting information system provides data for periodic reports, special reports, mathematical models and knowledge-based models. Marketing Research subsystem gathers from customers and prospects and collect data. The examples of data sources are surveys, in-depth interviews, observations, controlled experiments, mailing lists, retail sales statistics, video retrieval systems.

Using Information Technologies in Marketing

The new economy is a creation which was formed by today's global competition conditions, has affected the whole world and showed its effects in markets structure and marketing. The functions of marketing are buying, selling, storing, transporting, standardization and classification, risk taking, financing, getting information about market and training of employees⁵. In the traditional marketing who would have realized these processes for which products have been defined. In addition to realizing these processes has been taking more times. Also the costs for enlarging organization's field of activity are very high. In the web marketing everyone who has an internet connection is a customer or a supplier for each other. In this way, organizations have pulled away the local area. In the traditional marketing, communication costs take big source for organizations but in the web marketing it has decreased. Holmlund and Koch say that traditional marketing has not have viewpoint for making long-term contact with customer and developing these contacts. New economy has got the organization's behaviors more customer-focused. In this term to build long-term relations with customers and transform them to correlations has turned to key of the profitability⁶. The transformation, has directed the organization to customer-focused marketing. To the customer-focused marketing, the missions of the organization are to determine the needs, wants, profits and interests of target market and to offer the aimed satisfaction by increasing the customers' opulence with more affected and abundant than rival firms. Now it is not enough that the organizations can satisfy the customer needs. They must supply the changeable individual customer needs and that has been an essentiality. In the web marketing, permission has been taken from customers⁷. Direct marketing which has been improved with the aims of customer-focused marketing has become more effective in information era by using customer databases. At that, the information of customers as age, birthdays, salaries, hobbies, old shopping information and the other data have been used for organization faster. The organization which has more information about customer, are able to send advertisements, promotion, new products, messages and congratulate the special-days of customer with e-mail. This way the organizations are closer to their customers. In addition, the developments in IT have offered direct communication with customers. The electronic markets and customer services phones can be reached 7 days a week 24 hours a day. By using these, customers can give an order and mention all thoughts about the product and services.

⁵ Young Murray A. And Sauer Paul L., "Organizational Learning And Online Consumer Information Services", Journal Of Consumer Marketing, Vol.13, No.5, p.35

⁶ Helm Cristopher, "Crm Overview", [Http://Www.Marketingpower.Com](http://Www.Marketingpower.Com), p. 1-6

⁷ Ersoy N. F., Karalar R., Yeni Ekonomide Pazarlamanın Değişen Yönü, "www.Bilgiyoneti.Org"

Information technologies have exposed e-commerce by the way of getting new properties to the actual working forms. E-commerce (electronic commerce or EC) is the buying and selling of goods and services on the Internet, especially the World Wide Web. E-commerce is a form of commerce which has been used by a lot of sectors and can be reached 7/24 by customers. It contains the gathering and use of demographic data through Web contacts; e-tailing or "virtual storefronts" on Web sites with online catalogs sometimes gathered into a "virtual mall"; business-to-business buying and selling; the security of business transactions; Electronic Data Interchange (EDI), the business-to-business exchange of data and e-mail and fax and their use as media for reaching prospects and established customers

In point of substances and principles e-commerce is linked to traditional commerce and most of times it has used the same methods. Because of this e-commerce is not a new commerce which is an alternative of traditional commerce. But it is only a new commerce format which uses information and communication technologies. Simple local businesses such as specialist record stores are able to market and sell their offerings internationally by using e-commerce. This global opportunity is assisted by the fact that, unlike traditional communications methods, users are not charged according to the distance over which they are communicating

The USA Information Substructure and Applications Working Group have defined the e-commerce as:

"E-commerce, has integrated the communication, data management and security services and permits the information exchange between the different organizations. Communication services transfer the information which comes from source, to the recipient. Data management services define the formats which have been implicated for the information exchange. Security services determine the real identity of information source, search the verity of information which has reached to the recipient, and prevent the opening of information to the unauthorized users and verity the information has reached by the aimed user. "

E-commerce has changed the structure of product and service markets; entailed the new product, marketing and distributing styles; permitted to develop the new products; simplified to analyze needs of customers and replied quickly to changes of the demands in the markets. In addition, e-commerce has involved the increasing the commercial actions, enlarging the market territory and raising the economic condensing. This way e-commerce has exposed a lot of new works, jobs, missions and titles. It has been decreased the number of traditional managers and increased specializing and efficiency. Competition formats have been changed with e-commerce. Before e-commerce only big firms could reach a great number of customers, but now by using Internet little firms can reach significant numbers of customers. That is because the marginal costs of reaching and serving to customer have decreased. E-commerce will have been sustained to increase accessibility to markets and to decrease operation costs. After all, customers will get to know information of a product from a lot of seller about properties and cost by using internet. They will compare the differences between properties and costs. So the sellers must diversify products, services or distributing channels or apply price cuts. E-commerce has been directed the organizations to a transformation. Most of them have web sites for communication, marketing or introduction. These web sites are basis of online marketing which is formed by introducing the products or services on internet. Web advertising is another concept which is in the online marketing. It is the advertising of the products or services which are presented on internet. Nowadays people use internet for all sorts of operations so the value of web sites and the number of visitors have gained. Accordingly the organizations have attached importance to their web contents. That interaction has increased the importance of web advertising and online marketing. Online marketing has been made by presenting the advertisements to target group on the web sites. It

is the marketing of products or services over the Internet and used for advertising of a trademark, organization or a web site by banners, enlarging traffic of the visitors of web sites, reporting the response of users and customers and forming the strategic targets of advertisement campaign. The number of organization that prefer online marketing has been increasing daily. That is because online marketing generates interactive, personal, measurable, economical, definite solutions. It is inexpensive when compared to the costs of traditional marketing. Organizations can reach a wide audience for a small fraction of traditional advertising budgets, communicate with the target group directly, collect a lot of data and take reports about them simultaneously. Companies are relying increasingly on IT and computers to store, index, and analyze more and more information about their customers.⁸ Having these information and measuring statistics and responses are easily and inexpensively. Almost all aspects of an Internet marketing campaign can be traced, measured, and tested. In this cyber market place face-to-face communication has been taken away. Customers have been buying the products by seeing photos and reading properties. The customers of information era examine the contents of the web sites. So that nowadays the organizations are updating web sites for the formats of this new buying and selling. An organization which has opened to the whole world by internet, can transform all opportunities to advantages. Their web sites and services must supply satisfactions at all of the processes that begin with the first visiting of customer to the using the product or taking service.

Conclusion

Information technologies and internet have introduced a high-speed transformation to the current business. The traditional marketing and business forms have been changed, and the marketing activities have been advanced by internet. With this change traditional marketing functions have differentiated their processes, speeds and functions. Anymore the market is customer-focused, accessible at anytime from the anywhere. The organizations that want to stay for a long time must protect the information security and not share them with third persons. Furthermore, they must protect the credit cards numbers with advanced security software, realize the identification and authentication and update the contents of web sites periodically. After the service all kind of suggestions, desires and beefs must be considered. By this way, the trust and customer loyalty will be formed. The organizations will transform the opportunities to advantages and come forward in the competition. The governments have to apply urgent action plans for the organizations that want to take more advantages of electronic markets. They must strengthen substructure, increase the band width, generalize e-government applications and put down the costs of internet access. In addition, they have to ensure security for all internet operations by sustaining the electronic signature and to protect copyrights and to blank out censorship for information security

⁸ Rapp, S. & Collins, T.L. (1987). *Maximarketing*. New York, McGraw Hill.

Figure 1 Framework of a Marketing Information System, Mcleod and Rogers

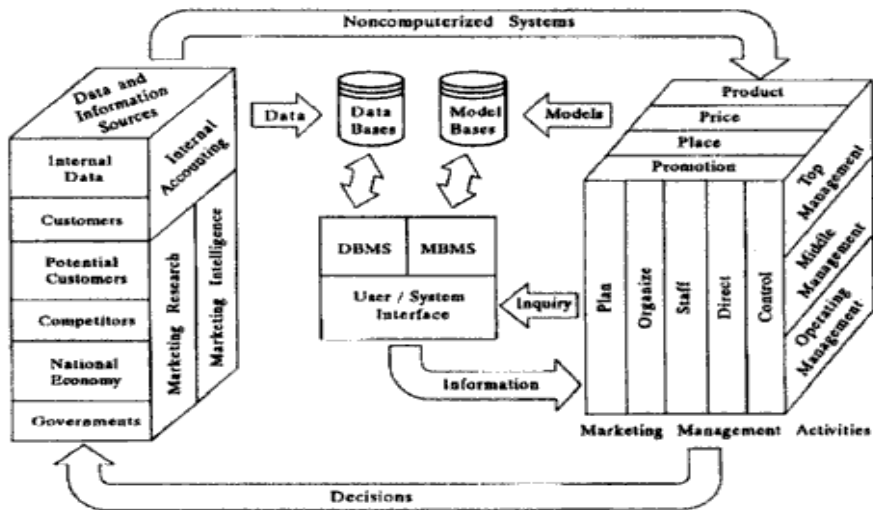
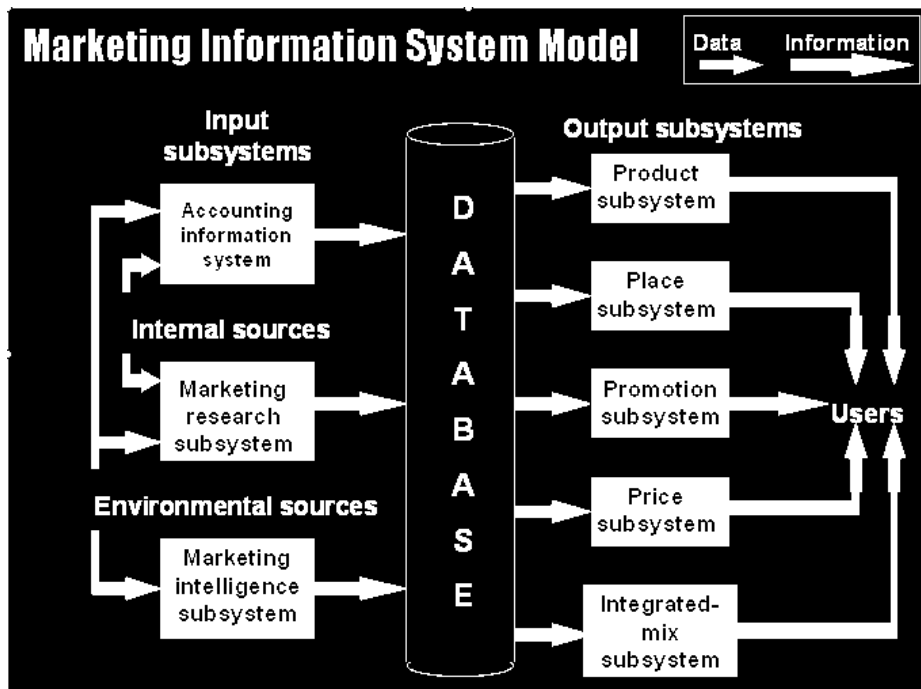


Figure 2 Marketing Information System Model



Source: Jarl M. Talvinen, "Information System in Marketing", European Journal of Marketing, Vol.29, No.1, 1995

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EDUCATION AND ECONOMIC GROWTH

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Abstract

This article considers relation which is established between education, human capital and economic growth. The goal of the article is to show concrete suggestions in relation to the influence of education on raising the living standard, based on up-to-date researches. Education itself represents one of the primary components in human capital formation, which is an important factor in modeling the endogenous production functions. The more important the component of human capital in modeling the economic growth is, the more significant the influence for using the technical progress achievements is. Human capital is of essential importance for achieving the sustainable growth rates for developed countries, but the greatest contribution is accomplished through the investment in quantity and quality of primary and secondary education for developing countries. On the quality of the education system depends formation of the human capital that is an important factor and supposition of the economic growth.

Key words: *human capital, economic growth, education, rate of return, capital.*

Introduction

The subject of this paper is to examine the influence and relations between human capital and economic growth. The human capital is the most important determinant of a capability of the country's national economy to produce and acquire technological innovations, i.e. technical processes achievements. Technical process is the key element in growth decomposition. As Simon Kuznets once said, the key element for the growth of the western countries is not the material capital, but knowledge mass gained through verified research, empirical science breakthroughs, as well as the population's capacity and training to efficiently use the above mentioned knowledge (Kuznets 1955, 7).

Thus, for example, the major part of the material capital in both Germany and Japan was destroyed during the II World War. However, these economies succeeded to recover in a relatively short time because the skills, experience, education, discipline and motivation of the existing workforce remained untouched. The concept of capital is traditionally placed within the framework of the material means of production, but in this way, skills and capabilities that are justified by investing in human capital are indirectly excluded. In 1960, Theodore Shultz suggested that activities related to education and training should also be regarded as a process belonging to capital accumulation i.e. by investing into human capital which could be translated into productivity and income growth (Schultz 1961, 12).

Investment in human capital includes both tangible assets and intangible assets that are used for the purpose of improving the quality of workforce by means of healthcare, education and existing workforce skills improvement. Like any other investment, these investments also require some kind of sacrifice on the part of the individual. These individuals are, again, willing to make such kind of sacrifice if they expect to be rewarded for it in the future with, some sort of benefit. The human capital is formed, initially, by person's education and training which in turn enables the better productivity of that individual, i.e. enables him/her to earn higher wage.

INVESTMENT IN HUMAN CAPITAL

Education is a key investment in human capital. It helps a person to achieve and apply his/her abilities and talents. In developed countries in the process of determining wages, intellectual capabilities are much more important than physical (abilities), when great majority of people is concerned. The school system in the majority of world countries is employed to essentially reproduce class structure; for example the graduates from the best schools earn significantly higher wages than those from inferior institutions. The high quality of education is the best guarantee for the capability to acquire new skills and knowledge. Precondition for investing and spending money on education and healthcare, either by a private person or by the state, rests on a belief that in this way one increases the income and productivity in the long run. The additional income and output that are produced in this way are simply the result of investment yield.

Education yield can be defined as a discrepancy between the increase in wage that one worker receives on the bases of one year of schooling compared to others. The effect of education on wages, based on a research, point to the following: yields from education are 13.4% higher per one year of schooling during the first four school years, i.e. 10.1% higher in the following four years and 6.8% higher after the completion of the eight grade (Hall and Jones 1999, 6). This means that a worker would earn 13.4% higher wage after the completion of the first year of schooling, i.e. 1.134^4 times more when he/she finishes elementary school (first four grades), than a worker that has no formal education at all. If the worker completes 5 years of schooling this difference would be even greater and it would be $1.82 (1.101 \times 1.134^4)$ since the yield per year from the 5th – 8th grade is 10.1%. The education, thus, contributes to differentiation in wages for different individuals.

Such yield could also be measured by workforce pondering index, where the particular ponder is measured by contribution through which education influences discrepancies between wages of individuals. In order to determine and derive this index, the data on distribution of workforce per year of schooling should be collected first, as well as information on discrepancies between wages that is caused by difference in quality and duration of education. One of the assumptions related to in index derivation states that the discrepancies in wages are produced by differences in education. This approach is in some way arbitrary, because basically it is very hard to determine education yield within the proportion of wage differences.

However, economic and real yields from education can be different which results in lower yields or insufficient exploitation of human capital for the following cases:

- Quality of education during the schooling is low;
- The knowledge acquired by education process does not match the knowledge demanded by the labor market;
- Insufficient demand for human capital due to the low rate of economic growth;
- There is a relative balance in workers' wages whether they have lower or higher qualifications, or the differences are so small that the motivation for additional investment in the quality of workforce decreases;

Considering the number of completed school years (defined by school years or by the highest level achieved), as a rule, the employees' wages increase till the maximum level, which is usually reached at the age of 40 or after; and it is only then that wages stabilize or possibly decrease. For those who have higher education wage curve is higher and the increase phase is sharper compared to those who have lower wages and have started their working career earlier - but whose educational level is lower. Those who have higher educational level reach their maximum wage later, but then again they have higher pension compared to those who have lower level of education.

The education itself is followed by two types of costs: implicit and explicit. Implicit costs are related to loss of wages during the studies, which would have been otherwise earned if that particular individual had been working instead of studying. As a person gets older and the level of education becomes higher, these costs increase. Explicit costs are related to monetary expense. The obvious example of such expenses is school fees. Even if the studies are “for free” there are expenses related to the purchase of books, travel and other purposes. Although such expenses can be moderate they can also represent the real obstacle for education of children that live in poor families.

On the other hand, in order to improve educational level subventions should be reduced, because there is a natural tendency to purchase too much goods which are cheaper than other products and services. Reduction of the level of subventions related to education and getting nearer to the real costs represents the application of market-related solutions but does not take into consideration the criterion of equal distribution. Some of these measures by which we reach more adequate distribution (by applying market principles on education) are related to liberal application of scholarship for poor students who earn it by their good learning record, as well as by using loans and vouchers that could be distributed to a larger interest group. This interest group would make purchase of the above mentioned loan/voucher according to the consumers’ choice of the type of studies that is in his/her opinion most useful.

There are different issues that are the part of investment in human capital and they include: organized formal education, additional education of adults, institutionalized training, study programs, improvement of the healthcare service efficiency, etc. So, there are three main types of learning, i.e. education:

- Formal education in schools/educational institutions, for that part of the population that does not belong to workforce category;
- Non-formal education which is implemented through organized learning programs outside formal educational system whose participants are adults and whose training programs are usually focused, concentrated and short. This particular type of education is easily available and it occupies short time period. This particular type of education is practical, cheap and flexible and it is available for those groups that have lower income. Although there are successful non-formal education programs, they can only be treated as a supplement to the formal education.
- Informal education is the form of education that exists outside the institutional educational framework or organized programs; it is characterized by home-schooling, on-the-job training or learning from a member of a local community. This type of investment can overcome many workforce characteristics that appear as limits to increased production (for e.g. lack of private initiative and lack of workforce mobility, fear of changes, not educated well or at all), not accepting new knowledge, etc.

Improvements in healthcare, education and other social activities can have a significant influence on workmen’s wages and productivity and they can also represent the precondition for introduction of more sophisticated, more advanced technologies into manufacturing processes. Better competence of workers would improve economic growth, because as a rule qualified workers are more productive. There are many ways in which the workers by investing in themselves improve and develop their natural capabilities – but most of such activities include learning and practical work. To sum up, education, practical training and experience are the basis of working capability improvement.

Practically, specifically produced knowledge about manufacturing processes is gained through experience and it is disseminated between the workers by means of informal training. All of this enables future improvement of production efficiency. A country can advance technologically not only through educational training, but also through gradual production

increase as a process of experience accumulation from the part of the workers, managers and other persons who take part in the manufacturing chain (learning by doing) (Arrow 1962, 1). This enables improvement of productive efficiency in the future when this particular learning process is concerned. Adam Smith used the term division of labor. The advantage of the division of labor can be seen in improvement of worker's skills, time saving and further improvement of machines that are used by the work force. Division of labor leads to improvement of the accumulated knowledge base. Also, through learning process workforce gains experiences and skills that help them to better perform their job tasks. If the work process is seen as the production system input, through addition of new factors, then the same process can be characterized as endogenous. In any moment in time, new machines in the production process, develop as a result of the available knowledge and accumulated experience related to the existing technology. Learning curve connects direct working input per unit of output with cumulative output as a measure of experience. For any product in question, learning cannot maintain the growth of the corresponding rate of productivity permanently. However, product types continuously change and this prevents occurrence of limits in the learning process that is on the aggregate level. This stands for a large number of business activities. When studying the manufacturing processes, it is virtually impossible to establish conformation of the work input to the process of learning through practice, thus contribution of this factor remains residual factor in economic growth.

Education as a macro determinant of the economic growth is an important variable for each research. Contribution of education to the economic growth can be measured if this variable is used for description of discrepancies in growth rate. The simple expression by which education would be included into determination of the growth rate would be the following:

$$g = a + b(PCY) + o$$

g – average growth rate during determined period of time;

PCY – initial rate of per capital yield;

o – education measured by proportion of age groups which are registered in primary and secondary schools in each country, i.e. average value of schooling years;

$a + b$ – exogenously determined parameter constants.

Coefficient o measures contribution of 1% point of difference in years of schooling and the differences in growth rates. According to one research, each additional school year would be on average related to 0.3% higher growth rates of per capital yield during the time period from 1960-1990 (Barro 1991, 2). The rapid growth of East Asian economies is undoubtedly the result of great investments in education. Some earlier studies also determined the importance of the education for the economic growth. Denison found that contribution of education to the increase of per capital growth is actually 40% (Denison 1962, 5). On other hand it is very hard to determine yield rate from education. Yield from investments in education is higher than the yield from investments from other forms of capital (Schultz 1961, 12). The importance of the education in the economic growth process is proved by the research conducted in developed countries and it is supported by quantitative evidence (Navaretti and Tarr 2000, 8). The importance that the investments in human capital have is the same as the importance of investments in material capital, and empirical research justifies this thesis. Economic yields on investments in education in most cases transcend yields from alternative forms of investment and so developing countries, in this respect, usually have higher yields than developed countries.

The highest yield rates originate from investments in primary education, which is consistent with the fact that there is a strong link between the level and growth rate of per capital yield and population proportion within the primary education framework (Colclough 1982, 4). Majority of countries is, thus, dedicated to providing free of charge primary and

secondary education, because it is here where the positive results of the externalities have the biggest value (considering reduction of poverty and salary discrepancies). Although primary education is universal, for many developing countries it is the goal that is still impossible to achieve. Countries which are characterized by low income do not have sufficient public funds which can satisfy the growing needs of population for education. These funds are not only insufficient but their allocation is also unevenly distributed between rural and urban, poor and rich part of population. There is also the issue of gender gap that is reflected in the smaller number of girls that are entered to schools compared to the number of boys; this is especially evident in primary schools. This gap actually reflects cultural norms and traditional perception of the female role in society i.e. those women should stay at home and take care of the household and family; this conception is present in many parts of the world (Middle East, South Asia and Sub-Saharan Africa).

The whole country benefits if its citizens know to read and write, i.e. if they fully take part in the economic and social life. Traditional customs and attitudes cannot be significantly changed until the greater part of the community becomes acquainted with new ideas through educational process and does not achieve elementary literacy. Thus, the yield rate is as a rule greater when the share of population included in education increases. At the same time tertiary educational institutions (both public and private) usually charge school fee because the individual receives greater part of benefits compared to the society as a whole. Yield rate from education at all levels (primary, secondary and higher education) tends to decrease with higher level of development. Since the rates of inclusion in educational processes are higher in developed countries, such attitude suggests effect of the law of decreasing yields. Considering the higher education in countries of high per capital yield, social and private yields from education are almost equal, because the most direct costs are paid by the participants in education, i.e. students themselves. And besides the mentioned expenses there are also opponent costs such as loss of wages which is caused by inability to work during studies. Investments in education in all countries, especially in the less developed countries are cost-efficient. Social yield from investments is the highest when the primary education is concerned (in developing countries) which is verified by empirical research (Psacharopoulos 1994, 11).

Table 1 shows how the level of education changed between 1960 and 2000 monitored on the observed sample: 73 developing countries, 23 developed countries and the USA. In 2000 about 34% of adult population did not have any kind of education in developing countries, in developed countries this figure was 3.7% while in the USA it was 0.8%. In developing countries only 3% of adult population has higher education, in developed countries 13% and 24.5% in the USA. On average, when the adult part of population is concerned, the number of school years has risen in developing countries for 3.1 and in developed countries for 2.7 years. The costs for education in the USA in 2000 were 6.2 from GNP, while in the same year the investments in material costs for education in the USA were 17.9% from GNP. In many developing countries, the rapid growth of population results in the great share of young people in schools (concerning the total population), thus the burden of educational expenses is also large, and also the quality of investment is much more different from those in developed countries.

Table 1 Changes in the Level of Education, 1960-2000

| | | Percentage of the Adult Population with | | | | |
|------------|------|---|-----------------|----------------------------------|------------------------------------|---------------------------------|
| | | Average Years of Schooling | No Schooling | Complete Primary Education | Complete Secondary Education | Complete Higher Education |
| Developing | 1960 | 2,05 | 64,1 | 17,1 | 2,5 | 0,4 |
| Countries | 2000 | 5,13 | 34,4 | 43,0 | 14,8 | 3,0 |
| Developed | 1960 | 7,06 | 6,1 | 72,9 | 20,2 | 3,0 |
| Countries | 2000 | 9,76 | 3,7 | 84,6 | 44,7 | 13,0 |
| United | 1960 | 8,49 | 2,0 | 78,4 | 31,0 | 7,0 |
| States | 2000 | 12,05 | 0,8 | 94,9 | 68,1 | 24,5 |

ISource: Barro, R. and J. Lee, International Data on Educational Attainment Updates and Implications, NBER Working Paper 7911, 2000.

There is no doubt that need for education is a very popular one. In developing countries, the number of people who request the admittance to school is much bigger than the number of available posts. All over the world there is the opinion that education is beneficial for everyone, primarily, because it is in high correlation with income concerning the individual as well as total population. This not necessarily means that university educated people earn more money then people with high school diplomas, but on average great majority of people with university degree earn more money. Correlation between the level of national income and educational achievements is also strong. People intuitively tend to secure maximum level of education for themselves as well as for their children, thus this item represents great expense for the budget of one household and also at the level of national economy, because each state gives significant funds for functioning of educational system.

Expansion of capacity at one level of education only increases number of people that apply for the next higher level of education. Paradoxically, the continued boom related to demand for education is followed by the decrease of benefits for an individual. The growth of unemployment of the educated part of population posts logical question on magnitude of funds that are given for the expansion of the educational system. The differences between different countries, concerning the education, reflect governmental efforts in those countries to increase the flow of human capital. A particular level of education is naturally required for certain job positions. In growing economy, the occupational structure is changing dynamically as well as the need of economy for particular occupational profiles, so it is necessary to define the patterns and direction of education first. In many developing countries, the number of people that have adequate academic references increases more rapidly than the number of available jobs; in this way the graduates are left without job for longer periods of time and they accept lower salaries than the salaries which their employed colleagues have already secured for themselves.

Table 2 Education Statistics in relation to GDP per capita and for selected countries (1995)

| GDP PER CAPITA (PPP) | % of illitera te adults | Enrollment Ratios | | | | Public Expenditure per pupil (\$) | | | |
|----------------------------|----------------------------------|-------------------|-----|----------------------|----------------------|-----------------------------------|---------|-----------|--------|
| | | Primary school | | Secondary school, | higher education, | % GNP | Primary | Secondary | Higher |
| | | Gross | Net | gross | gross | | | | |
| By Income Group | | | | | | | | | |
| Below \$1,000 | 49 | 68 | 42 | 20 | 1 | 2.4 | 25 | 100 | 1950 |
| \$1,000- 4,000 | 31 | 105 | 93 | 55 | 8 | 2.9 | 120 | 400 | 950 |
| \$4,000- 7,000 | 12 | 105 | 91 | 67 | 25 | 4.5 | 400 | 400 | 1300 |
| \$7,000- 12,000 | 12 | 108 | 92 | 72 | 23 | 5.7 | 870 | 900 | 2700 |
| Above \$12,000 | 5 ^b | 103 | 97 | 106 | 59 | 5.0 | 4500 | 5800 | 8500 |
| For selected countries | | | | | | | | | |
| Tanzania | 28 | 66 | 48 | 5 | 1 | 3.4 | N.A. | N.A. | N.A. |
| Sri Lanka | 9 | 109 | 100 | 75 | 5 | 3.4 | N.A. | 119 | 678 |
| Bolivia | 16 | 95 | 91 | 37 | 24 | 4.9 | N.A. | N.A. | N.A. |
| China | 17 | 120 | 100 | 75 | 5 | 2.3 | 56 | 129 | 2110 |
| Indonesia | 15 | 115 | 97 | 48 | 11 | 3.4 | N.A. | 73 | 143 |
| Brazil | 16 | 120 | 90 | 45 | 12 | 5.1 | N.A. | N.A. | N.A. |
| Columbia | 9 | 113 | 85 | 67 | 19 | 4.4 | 227 | 249 | 815 |
| Hungary | 1 | 103 | 97 | 98 | 25 | 4.6 | 929 | 916 | 2120 |
| Chile | 5 | 101 | 88 | 75 | 30 | 3.6 | 487 | 521 | 906 |
| S. Korea | 3 | 94 | 92 | 102 | 60 | 3.7 | 1983 | 1361 | 633 |
| Japan | 2 | 102 | 100 | 103 | 43 | 3.6 | 7365 | 7250 | 5304 |
| United States | 2 | 102 | 95 | 97 | 81 | 5.4 | 5380 | 6921 | 7183 |

Source: *UNESCO Statistical Yearbook 1999* (Paris: UNESCO, 1999) i *World Bank, World Development Indicators 1999* CD-ROM.

The growing economies give more funds for improvement of all forms of investment in human capital. This in turn influences the economic growth, above all through increase of productivity. Table 2 points to the value of public expenses in countries that have average income from 4-6% BNP. The countries with low income give smaller proportion of BNP for the same purposes. From 15-20% of government budget is on average given for education, which makes this activity one of the biggest activates, considering the newly added value as well as the number of employees. Regardless limitations, education is good investment in majority of countries with low or medium income, because yield rates from education are very high. The highest social yields come from primary education, especially in the countries where this type of education is far from universal.

In countries where almost everyone has primary education, the yield rate becomes undetermined because there is no lower level of education to which a comparison could be made. The margin between private and social yield rate can be large, especially where the countries themselves pay for the largest part of educational expenses. Where the expenses of education are financed privately (as for example higher education expenses in OECD

countries) margin between these two yield rates is much smaller. Yields from education tend to decrease as a country becomes more developed because the workers with some level of education are not scarce anymore and thus “regulate” lesser share on the labor market.

CONCLUSION

Rational state and government would invest in these forms of education that bring the highest national yield and would reduce the funds for those forms of education with low yield rate concerning the society as a whole. From the society’s point of view, higher wages are not justified if they are not caused by higher productivity, thus the role of education is not only to educate people but also to select individuals that would have the best references on the labor market.

In order to generate balance of economic and real national yield, the changes on labor market must be monitored as well as the request for knowledge and skills that are being established in one economy. The capacity of absorption of the social capital can depend, among other things, on investments in human capital. Thus the proximity of relations between determinants of human capital and economic growth is created. There are at least several ways in which education can influence and improve growth performances:

- Education has the effect of externalities on other sectors in society, which prevents influence of decreasing yield on capital; thus, for example, population characterized with higher education will probably have more honest and more efficient government. Educated people, as a rule, are the first to accept innovations, and only then are those innovations disseminated to and copied by less educated population.
- This activity has one of the most significant influences on attracting foreign investments;
- Education represents the most important input activity for research and scientific development;
- The influence by which application of knowledge improves the quality of material capital and workforce skills cannot be doubted.

The whole system of education should create and develop person’s capability for innovations and their acquisition in order to provide effective support to the processes of economic development. In competitive economy, educated individuals that lack the ability to think innovatively and who are not skilled in problem solving are faced with a greater risk of low wages and unemployment. Thus the investment in education is not only the need to increase human capital stock but also a necessity to achieve higher standard of living. Data on education represent an important indicator which reflects the quality of living in some country.

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INTERNET USAGE AND ELECTRONIC BUSINESS DEVELOPMENT IN KOSOVA

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Abstract

Worldwide, more and more companies are using the Internet as a medium for the development of business through electronic means. Internet usage has changed the business process in many companies, whereas electronic business has been accepted as a new form for the realization of digital business transactions, without use of hard copy documents and direct contacts in the business process. While the economies of western countries have started to utilize new forms of business through the Internet, in Kosovo we have just started to talk about electronic business, and neither have the advantages of B2C business been yet discovered. New technologies and the increase of their usage, especially the Internet, have changed the traditional business manner and enabled the overcoming of time and space limitations in communications and business development, and have increased the efficiency of the business system work, creating new business forms and models, which meet the needs, desires and requests of the consumers.

Firstly, such a paper aims to emphasize the opportunities of Internet usage for business purposes in Kosovo, and the need to raise the awareness amongst the business community so that they accept such new model of digital business if they intend to be competitive in the market.

Key words: Internet, Electronic Business, B2B, B2C and EDI.

1. Introduction

The growth, integration and sophistication of Communication and Information technology (CIT) is changing the society and the economy, and is impacting that, on the one hand, many industries undergo changes, and on the other hand, new business forms and models are created based on the Internet, as well as the use of information systems and computer networks¹. New communication and information technologies have changed the traditional business manner, by reflecting the manner of their development, and simultaneously by bringing it closer to the needs, desires and demands of the consumers.

Worldwide, more and more companies are using the Internet not only for communication and provision of information, and for the realization of business with consumers, such business which from the consumer aspect is known as electronic business model B2C (business to costumers), but also for the development of business electronically with other enterprises, by actualizing a business trend known as electronic business between two enterprises or B2B (business to business).

¹ A network is a way of connecting computers so they can communicate with each other and share responsibilities like printers and other devices. Networks include the Internet, Intranet (internal network within an enterprise's firewall) Extranets, (networks using Internet/intranet technology that permit businesses to securely share information with selected suppliers, parting customers, or other businesses).

Taking into account the exponential growth of the number of Internet users, and the great impact of Internet usage in all fields of life, but also in the development of contemporaneous business, and noting that, despite the fact that an increase of the Internet users has also been noted in Kosovo during these last years, but we lack data and research on the usage of such technology in the function of business development, efforts have been made to provide data regarding the Internet usage in such paper, with special emphasis in Kosovo, its role, importance, opportunities and advantages it offers for a successful development of electronic business and increase of work efficiency of business systems.

2. Internet – its Background and its Usage for Business Purposes

Internet is a general term which is used informally to describe a union of related computer networks. As a term, it was introduced for the first time in the 80's of the last century, whereas in the 90's the Internet started to be used by all. The foregoing project was ARPANet (Advanced Research Project Agency Network), which was funded by the Ministry of Defence of the USA (1968), the purpose of which was to find new ways for telecommunication system management, which would have decentralized governance and would enable distribution of information included in the computer. The USA universities joined such network in the 70's, whereas in the 80's the Academic Institutions of Europe. A turnabout on the Internet development and usage is marked in the 90's, when the Internet usage extended from the military and academic institutions to commercial usage. By the establishment of different presenting formats together with their transfer through the Internet, World Wide Web (WWW) was born and necessary preconditions for the Internet impact in the development of business activities were created [Z. Panian, 2005]. Such impact started to be noticed especially in 1993 when the enterprises started to bring to the Internet the electronic industry through electronic brochures (e-brochure).

The Internet² created a new space for communication, distribution of data and information and business development, by enabling the introduction of new information finding forms and cooperation between individuals. Although at the beginning nobody knew what such new medium offers, very soon it became one of the main communication and contemporaneous business development medium. The Internet provided the users with the opportunity to have access from around the world, and enabled the exceeding of time and space limitations for communication and business development between business entities, by impacting in the creation of an informative business environment for the enterprises and the introduction of new business forms and models, which were previously unknown.

Under the impact of the communication and information technology, the world economy is experiencing rapid technical, technological and organizational changes. Such changes are, first of all, a result of Internet expansion, which made possible that production, consumption and circulation exceed national borders and increase the dependency level between states. While previous technologies, such as electricity, the telephone technology, vehicle industry etc. required decades to reach the critical usage level, the Internet reached this only within several years. [V. Milicevic, 2002:24]. Currently, millions of people use the Internet through wireless modem equipment, through laptops or mobile telephones for everything: to purchase books, for games, to download music and films [Susanne Huttnner, 2007], but also to carry out business transactions electronically.

² Although the Internet operates as a unique network, it is in fact a decentralized network which has no owner, but operates based on the respected standards.

Much estimation on the number of Internet users exist in the world. According to Internet World Statistics³ the world Internet users estimate is 1.319.872.109 for year-end 2007, the penetration was 20.0%, based on the world population estimate of 6.606.971.659 persons. World average of Internet users was 20.0%, while in Europe penetration was 43.4%.

Internet Usage in Europe and Balkan countries in 2007

| | Population 2007 Est. | Internet users | % Population (Penetration) | Use growth 2000-2007 |
|---------------------|-------------------------|----------------|-------------------------------|-------------------------|
| Albania | 3.600.523 | 471.200 | 13.1% | 18.748.00% |
| Bosna & Hercegovian | 4.552.198 | 950.000 | 20.9% | 13.471.40% |
| Bulgaria | 7.322.858 | 2.200.000 | 30.0% | 411.60% |
| Croatia | 4.493.312 | 1.684.600 | 37.5% | 742.30% |
| Macedonia | 2.055.915 | 392.671 | 19.1% | 1.208.9% |
| Montenegro | 684.736 | 266.000 | 38.8% | n/a |
| Serbia | 10.150.265 | 1.400.000 | 13.8% | 250.0% |
| Romania | 22.276.056 | 7.000.000 | 31.4% | 775.0% |
| Slovenia | 2.009.245 | 1.250.600 | 62.2% | 316.9% |
| Kosovo* | 2.300.000 | | 3.5% | |
| Europe | 801.821.187 | 348.125.847 | 43.4% | 231.2 |

Source: <http://internetworldstatistics.com/stats4.htm>

Based on the same source, the European countries and the countries of the Balkans are characterized by a rapid growth dynamics of the number of Internet users. In 2007 there were 43.4% Internet users in Europe. There is an evident distinction between the Balkan states with regard to Internet usage. Slovenia has made substantial progress in this regard with 62.2% users, followed by Montenegro (38.8%), Croatia (37.5%) and Rumania (31.4%). Albania had the lowest percentage of Internet users with 13.1%. By September 2006, statistics gathered for Serbia as a whole showed 14.3% of the people to be Internet users⁴.

Very little data are available on Internet access and usage in Kosovo. Since 1999 in Kosovo there has been a rapid expansion of communications technologies and the growing interest in computer and Internet usage. While, in October 1999, just 0.45% of the population in Kosovo was Internet users,⁵ research carried out by Index Kosova in 2006 show that in Kosovo there were 6.3% computer users, but only 3.5% were Internet users.⁶ According to UNDP "Human Development Report 2006", although the number of young people with their own computer is still low, most young people know how to use one and some 75% of young people report using the Internet⁷. These figures accounts for increased awareness on computer and Internet usage in Kosovo, but the figures remain well below the level of the countries in the Balkan region. The main Internet services providers in Kosovo, is IPKONet providing services such as Internet access, data transport and inter-office telephony⁸.

³ Source: <http://www.internetworldstats.com/stats.htm> (downloaded: 26.03.2008)

⁴ Internet World Statistics: <http://internetworldstatistics.com/euro/rs.htm>

⁵ <http://www.lse.ac.uk/collections/polis/pdf/Kosovonetworkedcomms.doc>

⁶ Source for data: <http://www.indexkosovo.com>

⁷ This report is available at: <http://www.Kosovo.undp.org/repository/docs/hdreng.pdf/>

⁸ Source: <http://www.ipko.net>

* Data for Kosovo are for year 2006.

3. Electronic Business and its Models

Taking into consideration the increase of the number of Internet users and the many opportunities it provides, its natural to expect that, from the economic aspect, the Internet has become very important. In particular, the opportunities that the Internet provides for the development of business electronically are very important.

Today, it has become a habit to name the business development through the Internet usage electronic business. By using the expression electronic business, the aim is to show a rapid application of informatics and their products in business during these last 15 years, under which conditions the manner of business development is changing, and many traditional businesses are being transformed into new business forms and models, based on Informatics systems and the Internet. Electronic business was enabled by the Internet development as international network of computer networks and medium for communication, and the introduction of access tools to access some of its certain functions such as WWW and E-mail.

Although 1993 is considered as the year of commencement of business through networks, the real influence of the Internet in business is marked in 1996, when the famous company Amazon.com made available on the Internet the electronic book industry [U.Werner, 2002] thus making electronic business a reality. Basically, electronic business implies developed of business through computers, namely, through the use of Internet and digital technology, for the purpose of realizing business activities. It does not imply only purchase and sale, although, up to date, electronic business was mostly manifested in electronic commerce (e-commerce).

We do not yet have a general definition of electronic business. Even voluminous encyclopedia, such as the British one, defines electronic business (e-business) as electronic commerce (e-commerce).⁹ Explanation must be sought in the fact that from the very beginning, the changes caused in the manner of organizing the work of the enterprises, as a result of the development and application of Internet Technology and computer networks, and popularity of a new way of commerce development was called electronic commerce.

Author Z. Pianic defines electronic business as a contemporaneous form of business organization, which implies intensive use of Informatics and Internet Technology in the business development [Z.Pianic, 2005:281], and we consider that this definition expresses the essence of such concept.

In the knowledge society¹⁰ and under the conditions of the new economy, as a result of intensive Internet usage in business, the role and importance of information as well as of knowledge increased, and other forms of immovable property. Information became an important resource for the development of contemporaneous business and in the decision-making process. Application of Information Technology became an important success and business efficiency factor, whereas the enterprises underwent changes which may be compared with those that occurred in the era of being transformed from a pre-industrial society to an industrial one. While the industrial epoch is characterized with the

⁹ Although the expression electronic business was used in 1993, until 1997 the expressions electronic business (e-business) and electronic commerce (e-commerce) were used as synonyms of one another, even though there are differences between them. Electronic business presents a union of business activities, which are developed with the aid of information and communication technology, whereas electronic commerce is a narrow concept and presents only one form of electronic business, which implies the purchase and sale of goods or services through the Internet, in particular through the use of the service World Wide Web.

¹⁰ The term "Knowledge Society" reflect the essence of changes, connected with the growing role of knowledge and information in life. Knowledge Society is a new post-industrial social-economical organisation of society with highly-developed information and telecommunication infrastructures providing the possibility of efficient use of intellectual resource development of civilization.

transformation of physical resources, the new economy¹¹ is characterized with the transformation of non-material resources [V. Milicevic, 2002:4] and the success of the economy in the 21st Century depends on the capability of the enterprises to fulfil their needs, desires and consumer demands.

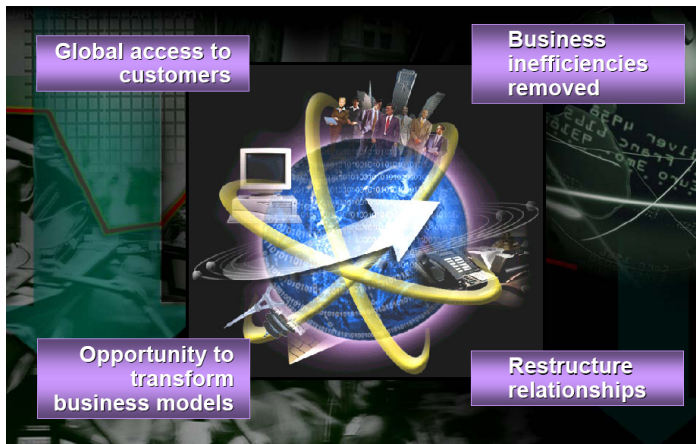
Internet usage for business purposes paved the way to the globalization process of the economy and world markets, by enabling the economic entities to place their products where they can ensure better income [V. Milicevic, 2002] and where economic values for the company may be created. Such changes had an impact for the unification of dispersed economies on a global scale and for the creation of regional and world integration.

Markets of the countries are narrowing, making the integration of different countries in the world economic processes necessary for the purpose of free circulation of people, goods, ideas, capital and services. In this whole process, information technology development had a great impact, in particular the Internet expansion, which had an impact on the increase of the market globalization trend, and the transformation of business manners on how to work, how to communicate, how to live and develop business. Under such circumstances, the enterprises have found themselves in a general competition environment. Thus, for them to develop business successfully, they must become part of global business processes, whereas the letter “e” (electronic) which we hear too often in our everyday language, and we find it to be used before the words such as business, commerce, marketing, banking business etc., is mainly related with the Internet terminology and the opportunities such medium creates for the increase of business effectiveness and efficiency [T. Lucey, 2005:244], and it shows the philosophy of adaptation and adjustment to the current world trends of business development, which must be followed by the enterprises, business entities and organizations, if they want to be competitive in the field where they develop their business.

The competition between enterprises and modern companies is not realized in the field of information technology application, but in the field of needs, desires and consumer demands fulfillment to the best possible. The most important competition factors are; innovations, product and service quality, time and low prices. [V. Milicevic, 2000:12]. This shows that the traditional manner of lowering costs and increasing productivity and business efficiency are not sufficient for success in a dynamic and information technology environment.

Under such circumstances, by acting in an environment where information technology is applied everywhere, as a result of the Internet impact for the transformation of the economy, with the aim to be competitive, the enterprises are obliged to increase their competitive skills and their presence in the global market. Internet usage for business purposes enables penetration into new markets and new market segments, by ensuring the consumers global access, whereas enterprises opportunities to transform business models and increase of business efficiencies, and restructure relationships with business partners.

¹¹ In scientific and professional literature, besides the expression new economy, expressions such as digital economy, Internet economy, economy of the 21st Century, virtual economy, web economy, economy based on information and knowledge etc. are also used. In all the cases, the intention is to show the impact of information and communication technology in the accomplishment of economic activities.



Source: <http://labs.adobe.com/technologies/digitaleditions/library/>

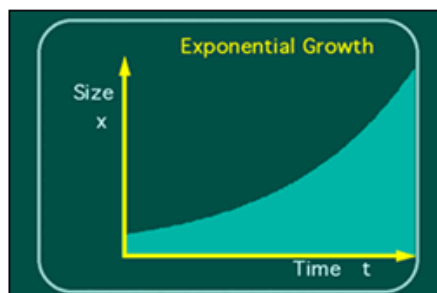
Therefore, currently, the aim of application of new information technologies and new computer choices is the link of technological opportunities with the needs, desires, and consumer demands [B. Djordjevic: 139].

Main trends for electronic business development deal with business models B2C and B2B, although other electronic business development models exist¹².

The business model B2C (business-to-business) is a model oriented towards the consumers, and aims to fulfil their needs with regard to the provision of products, services or information. Model B2B (business-to-business) means business process which is developed through business entities, with the support of information technology.

Although, in general, such business model¹³ is still in its initial phase, we may conclude that many organizations and companies use electronic business models¹⁴ B2C and B2B in order to develop business transactions with consumers and other enterprises [T. Lucey, 2005:247], because now everybody has understood that we are talking about a new way of developing business and presenting new business models, which previously were not possible.

Data show an exponential growth of business transaction development based on such models, and in the future it is expected to be created mobile business models.



Source: <http://www.portocontinental.si/B2C.htm>

¹² See: M. Gradisar, J. Jaklic, T. Damij, P. Balok: 2005, pg. 141

¹³ Business model is the way in which a company makes (generates) revenues (and profit).

¹⁴ Examples include Dell, which sells computers and other ICT hardware and software, Staples which sells stationary and office equipment etc.

The reason why Internet is widely used today for the development of business has to do with the fact that the business entities have understood that development of business through computer networks and the use of information technology provides them with more knowledge work regarding the business, with mobile workforce, and more rapid communication. Companies¹⁵ learn to compete in a new way, whereas consumers become powerful more than ever before [Carl Shapiro & Hal. R. Varian, 1998]. They use the Internet and computer networks to identify merchants, to find products and services, to compare prices, to purchase and execute payment [Thomas L. Mesenbourg].

During the last years, the number of Internet users has also increased in Kosovo by the business community, and some enterprises and organizations provide their presence online¹⁶. However, due to lack of data, we cannot exactly know the general number of enterprises which are present online and the type of services they provide. Some research conducted by Riinvest Instituti¹⁷ show an increase of Internet usage by the small and medium enterprises from 22.0% (in 2002) to 30.2% (in 2004). Nonetheless, the data that only 14.9% of the small and medium enterprises which use the computer have their Web-sites is a concern. Internet is basically used (41.8%) to communicate via e-mail, for market search (36.0%) and to promote their businesses on the Web (10.1%). We do not know the level of application of such modern business model by domestic enterprises, and by all chances, the percentage of the use of such technology for the development of business activities and commerce based on the business model B2C, still remains low.

The data that in the enterprises in Kosovo during the last years, there is an indicator on the usage increase of computer and Internet, is encouraging and proves that the business community has understood that, under the contemporaneous conditions for the development of business, the creation of a commerce image of the company, the establishment of visual identity and promotion of businesses in distance is of special importance. Furthermore, some enterprises have developed their services on the Internet, which make their businesses more rapid for the consumers and of better quality. However, while the business model B2B of electronic business has become a reality in the world, in Kosovo we still lack it, and no actions are noticed for the application of such current trend for the electronic business development, although the concept of electronic government (e-government) was mentioned as an option for implementation in the future¹⁸.

Some research and serious analysis view business model B2B as a model of future electronic business development in the 21st Century. [Z. Panian, 2000:115]. Today, electronic business is developed through computers, but with further developments of mobile telephones, more and more business transactions shall be conducted through such technology. Therefore, if such business model is not recognized by domestic enterprises, they shall stagnate further compared to the competition in the regional markets and broader.

It is worthwhile to emphasize that in order to develop electronic business necessary infrastructure must be ensured¹⁹: institutional, digital, legal and staff regulation. Enterprises should use computer networks and information technology, general standards for business

¹⁵ Reasons for the increase of Internet usage for the development of contemporaneous business are also the opportunities and potential which new information technologies possess to change the organizational structure of the enterprises, by enabling small enterprises to be competitors of big enterprises in electronic markets.

¹⁶ The term online is a synonym for Internet usage (to be on-line = to be on the Internet).

¹⁷ www.riinvestinstitute.org

¹⁸ The e-banking concept is also in the initial phase.

¹⁹ E-business infrastructure is the share of total economic infrastructure used to support business processes and conduct electronic commerce. It includes hardware, software, telecommunication networks, support services, and human capital used in electronic business and commerce.

communication, known as Electronic Data Interchange-EDI²⁰ and Extranets²¹ as communication infrastructure which links the different organizations [Z. Pianic, 2000:115].

Electronic Data Interchange is a technology based on which business is developed electronically, and it presents the interchange of structured data based on the previous set standards for the delivery of orders and electronic data interchange. Electronic Data Interchange or transfer of standardized documents and data is carried out between the applications activated in the computers of the companies or business entities [K. Stevica & M. Danimir, 1998:103]. We are referring to a system with universally acknowledged standards by the companies which develop their business between themselves [A. Kovacic, A. Groznik & M. Ribic, 2005:68], in which case the standardized data are forwarded in a format which enables automatic processing, with no need to intervene manually [T. Lucey, 2005:245]. It is obvious that electronic data interchange is a system of the future, and presents one of the key issues for the development of business electronically and for the economy of ones country.

The first forms of electronic data interchange are found in the 70's when the banks commenced the development of the system for the electronic transfer of cash, known as Electronic Fund Transfer-EFT. Electronic Fund Transfer, as a specialized form of data electronic transfer, makes possible for the computer users of an enterprise to include data electronically to the bank computers, by providing instructions to realize the payment through the relevant bank accounts [T. Lucey, 2005: 245]. Such form of electronic funds transfer is also applied in Kosovo.

4. Conclusion

Electronic business is a reality and presents a current trend for the business development on a world scale. It is not yet applied in Kosovo, and we lack the necessary infrastructure, although the first initiatives for its implementation are noticed. Knowing that due to our past our country is behind with regard to information technology usage, and taking into account that every technological enahancement if followed with new opportunities which cause changes to the business environment of the enterprises, electronic business should be considered as an opportunity for the inclusion of the Kosovo enterprises into the current trends of business development in the region and broader, and their representation in markets and new market segments.

The market of electronic business has progressed, and this is proved by the statistics of the increase of Internet users in the world and in the region. Also, it has been testified that companies which successfully apply electronic business, ensure quality services for consumers and manage to be competitive in the market in the field in which they develop their business. Stagnation in this regard means punishment with non-sukses. Domestic companies must face such challenge of contemporaneous business and to recognize such new business model if they want to be competitive in the market. Moreover, there is another strong reason to understand that future business models shall be mobile and that the computer networks shall continue to develop and their infrastructure to refine.

²⁰ Electronic Data Interchange (EDI) is a costly technology, and is mostly used by big enterprises. Small and medium enterprises use on-line services of Value Added Networks (VAN).

²¹ Although extranet as a computer network links two or more local computer networks (Intranets) of enterprises belonging to the same organization, in the globalization process, due to the use of contemporaneous technology computer networks, extranets may also be developed by enterprises belonging to the same organization. Extranet is the main computer network for the implementation of the B2B business model.

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ENTERPRISE RESOURCE PLANNING: COMPARISON IMPLEMENTATION PROCEDURES OF TWO COMPANIES

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Abstract

Advanced information technologies became absolutely necessary part of the companies in today's competition and velocity environment. The emergence of new information technologies is rapidly changing. One of the new information technologies is Enterprise Resource Planning (ERP) system. Companies adapt Enterprise Resource Planning because they want to decrease cost and increase the quality of their product and services. They also try to adapt their processes to more customer-oriented approach and effective customer reaction. The study aims to find out how adopt Enterprise Resource Planning implementation procedures is applied by two companies in Eskisehir province. Also, it identifies success factors, software selection steps, and implementation procedures critical to a successful implementation.

Key Words: *Enterprise Resource Planning, Material Resource Planning, Enterprise Resource Planning Software, Critical success factors, Implementation procedures.*

1. Introduction

The environment of business changes so rapidly. Companies face of increasing competition, expanding markets, and rising customer expectations. This puts pressure on companies to lower costs, expand product choice, provide better customer service, improve quality, and coordinate demand, supply, and production (Shankarnarayanan, 2000).

In competition environment businesses upgrade their capabilities, to stand competitive; must improve their own business practices and procedures. Therefore, businesses begin to implement enterprise resource planning (ERP) systems (Ptak, Schragenheim, 2000).

ERP contains businesses all functions and departments; and all business transactions are entered, recorded, processed, monitored, and reported. This provides departmental cooperation and coordination. But it enables companies to achieve their objectives of increased communication and responsiveness to all stakeholders (Dillon, 1999).

2. ERP

1960's inventory control was important part of businesses. Businesses tried to keep inventory, to satisfy customer demand and stay in competitive. Most software packages were designed to handle inventory based on traditional inventory concepts (Ptak, Schragenheim, 2000).

In the 1970's, it businesses could not consign of inventories. This led businesses to use material requirements planning (MRP) systems. MRP represented materials planning process

which is bill of material files that identified the specific materials needed to produce each finished item, a computer could be used to calculate gross material requirements (Ptak, Schragenheim,2000)..

In the 1980's, companies began to take advantage of the increased power and affordability of available technology. Manufacturing resources planning (MRP II) systems evolved to the financial accounting system and the financial management system along with the manufacturing and materials management systems. This system makes businesses to have a more integrated business system that derived the material and capacity requirements associated with a desired operations plan, allowed input of detailed activities, translated all this to a financial statement, and suggested a course of action to address those items that were not in balance with the desired plan (Ptak, Schragenheim,2000).

By the early 1990's, MRP II began to be expanded to incorporate all resource planning for the entire businesses. ERP can be used not only in manufacturing companies, but in any company that wants to enhance competitiveness by most effectively using all its assets, including information (Shankarnarayanan, 2000).

3. ERP implementation process

Enterprise systems software packages undertake integration of all information about financial and accounting information, human resource information, supply chain information, and customer information.

Implementation of ERP systems needs investment and time. Not only do ERP systems take a lot of time and money to implement, they can disrupt a company's culture, create extensive training requirements, and even lead to productivity and mistreat customer orders, at least in the short term, can damage the bottom line (Stein, 1999).

4. Procedures of ERP implementation

Implementing an ERP system is an expensive and risky. In fact, 65% of executives believe that ERP systems have at least a moderate chance of hurting their businesses because of the potential for implementation problems (Cliffe, 1999). Numerous authors have identified a variety of factors that can be considered to be procedures of an ERP implementation. These are described below (Sousa and Collado, 2000).

4.1. Strategic Aims

ERP implementations require that key people throughout the organization create a clear, compelling vision of how the company should operate in order to satisfy customers, empower employees, and facilitate suppliers for the next years (Latamore,1999). There must also be clear definitions of goals, expectations, and deliverables. Finally, the organization must carefully define why the ERP system is being implemented and what critical business needs the system will address (Travis,1999).

4.2. Top management Support

Successful implementations require strong leadership, commitment, and participation by top management (Holland et all, 1999). Since executive level input is critical when analyzing and rethinking existing business processes, the implementation project should have an executive management planning committee that is committed to enterprise integration, understands ERP, fully supports the costs, demands payback, and champions the project. (Akkermans and Helden, 2002).

4.3. Project management

Successful ERP implementation requires that the organization engage in excellent project management. This includes a clear definition of objectives, development of both a work plan and a resource plan, and careful tracking of project progress (Akkermans and Helden, 2002). And the project plan should establish aggressive, but achievable, schedules that instill and maintain a sense of urgency (Laughlin, 1999). The project and should identify the modules selected for implementation as well as the affected business processes. If management decides to implement a standardized ERP package without major modifications, this will minimize the need to customize the basic ERP code. This, in turn, will reduce project complexity and help keep the implementation on schedule (Axam and Jerome, 2003).

4.4. Change management

The existing organizational structure in most companies is not compatible with the structure, tools, and types of information provided by ERP systems. ERP system imposes its own logic on a company's strategy, organization, and culture. Thus, implementing an ERP system may force the reengineering of key business processes and/or developing new business processes to support the organization's goals (Bernroider and Koch, 2000). The changes may significantly affect organizational structures, policies, processes, and employees.

If people are not properly prepared for the imminent changes, then denial, resistance, and chaos will be predictable consequences of the changes created by the implementation. However, if proper change management techniques are utilized, the company should be prepared to embrace the opportunities provided by the new ERP system—and ERP will make available more information and make attainable more improvements than at first seemed possible. The organization must be flexible enough to take full advantage of these opportunities (Chang, 2004).

4.5. Implementation team

ERP implementation teams should be composed of people who are chosen for their skills, past accomplishments, reputation, and flexibility. These people should be entrusted with critical decision making responsibility (Daneva, 2003). Management should constantly communicate with the team, but should also enable empowered, rapid decision making (Chang, 2004).

The implementation team is important because it is responsible for creating the initial, detailed project plan or overall schedule for the entire project.

4.7. Education and training

Education/training is probably the most important critical success factor, because user understanding and buy the system. ERP implementation requires of knowledge to enable people to solve problems the system. If the employees do not understand how a system works, they will invent their own processes using those parts of the system they are able to manipulate (Laughlin, 1999).

5. ERP system selection

A Business that implements ERP has to accept the vendor's basic necessities about the business and change existing processes and procedures. Therefore, each business should try to select and implement a system that underscores its unique competitive strengths, while helping to overcome competitive weaknesses (Laughlin, 1999).

The company must identify its critical business needs and the desired features and characteristics of the selected system. Literature includes some recommended steps and suggestions for the selection process (Hong and Kim, 2001).

1. *Vision*: Define the corporate mission, objectives, and strategy. Use cross-functional teams and executive-level input to identify, examine, and rethink existing business processes. Once the vision is approved by top management, broadcast the vision to the entire company.
2. *Create a feature list*: A team composed of respected individuals who are familiar with the various software packages, company processes, and the industry should be responsible for identifying the features and functions required for the software to effectively support each functional area as well as the overall company vision.
3. *Software candidate*. The field may be narrowed based on criteria such as the size of the enterprise or industry type. Select only ERP providers that are right for the business. Business should analyze ERP system strengths and weaknesses of each supplier.
4. *Demonstration of ERP packages*. In order to provide a thorough critique, all key members of the selection team should be present for all demonstrations.
5. *Selecting ERP System*: When companies select their system, price is frequently a major factor. But it is critical not to underemphasize other important criteria such as supplier support, ease of implementation, closeness of fit to the company's business, flexibility when the company's business changes, technological risk, and value (total implemented cost versus total value to the company).

6. Research Methodology

This research was conducted using case study approach in order to have exploratory research on experienced success of ERP projects and implementation procedures positively or negatively affect the implementation projects. Exploratory research is defined as research type that has emphasis on the discovery of ideas and insights (Churchill, 1995).

In Case Studies, interviews are held with managers who have decided to implement ERP system of sample organizations, key users who involved in implementation projects, end users who use ERP packages in their daily business process and consultants and projects managers of ERP supplier who involved in ERP project implementation. Open-ended nature of interview questions helped to catch participant insights about the projects.

The name of the organizations and respondents are not revealed because of the confidentiality. Although it appears as it is an obstacle for research, this guaranteed the accuracy of information gathered through interviews with respondents.

This case study is a comparison of their implementation, including an indication of the degree to which they adhered to system selection guidelines, and implementation procedures described in the first part of this paper.

6.1. Brief history of Organizations

Organization A is a private organization that operates in the textile sector with their more than 500 employees and 4 factories in the different areas of Turkey. They are supplying the knitting, weaving and carpet industries with the finished primarily made of acrylic and wool in addition to various types of natural, artificial and synthetic raw material. The annual output is about 30.000 tons. This organization has been successfully promoting its trademark in local and international markets since 1970s.

Organization B is a private manufacturing organization that produces consumers' goods in food sector. It has different facilities in Turkey with more than 500 workers. The organization began to produce in 1968 and develops its production facilities and capacity since then. The Organization B's sales network includes 15 branch offices, 26 main distributors and 22 secondary distributors throughout country. It currently exports many countries including China, Hong Kong, Saudi Arabia, and Macedonia.

6.2. Strategic Aims

The business environment was rapidly changing to encourage more intimate business-to-business transactions with key customers, and the old system was not compatible with the newer systems that were being installed in the customer base. Future enhancements to the existing system were not expected, and Organization A and B, did not want to maintain in-house information system resources to develop the new capabilities and interfaces that would be required.

6.3. Top management support

Organization A realized that top management support is not effective at the stage of the project implementation; also it is not important for on going success of the system after the project completed. Project Manager states that the non-supportive behavior of the top management always puts project's unsuccessful.

In Organization B, the ERP system is highly supported by top management. This reinforcement of top management affected process success positively. Although project team felt this as pressure, this pressure made this project success real. They still believe that top management had given more support to project.

6.4. Project management

In Organization A, the execution strategy and implementation plan of the project was not well defined and made clear to all stakeholders. Project did not have clearly established goals to be met in line with the organizational strategic goals. The project manager says that the project scope was not realistic. The project's milestones were underlined informally, which affects the project success negatively. The project team consists of about five key users which have moderate qualifications to be a part of this kind of project according to Project Manager. They know their job well but they had not been in this kind of an important project before. Nevertheless, they are the best fit ones with in the organization. Another negative impact is the changes in project team composition with depart of two people during the project implementation period affects the project negatively.

In Organization B, the implementation plan of the project and execution strategy was well defined. It was also made clear to all stakeholders. There were clearly established project goals to be accomplished in line with the organizational strategic goals. They believe that the project scope was realistic. They used formal plan to define project's milestones and revised it when necessary. Project team was composed of key users from different departments relatively for ERP module needs. There were many consultants to work with. These key users knew their job well and worked with consultants effectively to design future processes of business. They were aware of their responsibilities and duties about project. There were not any changes in the project team composition during project.

6.5. Change Management

Organization A inadequately managed the change process. They did not take into account employee satisfaction with the new system. Top management was unable to impose to the employees their vision for change. Most employees did not understand the need for change. The process of change was not well managed. In the project, they face with user resistance to new system especially during redefinition of the business processes and the delegation and reassignment of work between departments. This resistance mostly comes into sight because of the massive change and rearrangement of duties with the new business procedures. Most of the project team members agree that this change was not managed properly. There might be many reasons for this. There was the limited time and resources mostly allocated to project for more technical and functional issues. Some team members state that this opportunity to change might have been used more effectively.

In Organization B, the project, they face high user resistance to new system. They use many methods to cope with this situation. They use different methods to convince people the

benefits of the system and make the acceptance of the system guaranteed. Preparing detailed procedures of new business processes, they tried to not to have any confusion anymore. Therefore, they realized project as not only an information technology project but also as a chance to bring change into their organization to make improvements on business processes.

6.6. The implementation team

In Organization A, the implementation team was selected from all functional disciplines. Twelve capable and knowledgeable people were selected. For some team members, a full-time commitment was added to their continuing daily duties and responsibilities. A better approach would have been to assign six multi-discipline individuals committed full time to the project. Additional expertise could have been attained as needed through interviews and temporary assignments to the project team.

Organization B has a project team which was the conference room pilot. A cross-section of products, processes, customers, and various scenarios were created and tested. Several new processes were evaluated and accepted or rejected. One particularly rigorous test was a series of complete order-to-cash process flows, where the transaction values were manually calculated in advance and the system results validated for accuracy and completeness. The conference room pilot was one place where the pressures of team members' daily responsibilities adversely impacted the quality of the project. In those functional areas that were represented by project team members that had sufficient time available to explore alternate process strategies during the conference room pilot, significant improvements were generated. But in those functional areas represented by team members that had inadequate time to dedicate to the pilot, the typical result was a substandard replication of the old legacy system processes.

6.7. Education and training

In the Organization A, project, necessary time and resources were allocated for training. The training program is conducted in two parts as the used methodology requires. First, consultants trained key users and then key users trained employees. However, project team members were mostly dissatisfied with training because of the time allocated. They think that more time would have been assigned to training. According to a member who is the manager of Information Technology department, timing of trainings makes confusions. Trainings were done after the definition phase so it was hard for project team to comprehend the program.

In Organization B, training was part of this project and handled successfully for the project team. The training program is conducted in two parts; first training of key users by consultants and second training of the employees by key users. For the consultants' point of view necessary time and effort were allocated to trainings. They claim that they comply with their standard training procedures. However, project manager states that they are not satisfied with the training because of two reasons: trainings might have been not satisfactory or the key users were not aware of the importance of these trainings. Another issue is the dissatisfaction of the employees with trainings given by key users.

CONCLUSION

ERP systems assure business process improvements and decrease in costs by functionalities of accurate and timely information, elimination of inventory and delivery problems, accurate customer and supplier base, operational linkage with multiple period accounting, multiple currency, enhanced supply-demand linkage and reporting simplicity and affectivity.

These project cases mainly show how ERP system implementations and integrations realized in Turkey. ERP systems are preferred specifically since they promise structured

business models and best practices. They are used as a tool to standardize business procedures and business flows, rather than the real ERP benefits considerations.

Organization B case study demonstrate successful ERP implementations in the sense of completing within the arranged time, allocated budget and fulfilling the expectations with accordingly. Procedures of ERP systems affect project success explicitly and implicitly of it.

Top management support plays essential role in projects; both in realization of project goals and keeping the live system alive effectively. It's the most important factor for employees to dedicate themselves to project. The ERP projects, requiring main changes in business practices, somehow disturbing normal way of doing daily operations, requiring qualified and trainable human resource, brings fear of losing jobs for employees. To cope with this kind of difficulties and make the acceptance of system certain, top management support is necessary. It is a must for a project to guarantee overall organizational commitment and proceed the critical adaptation process successfully. The Organization A case illustrates how lack of top management support risky system even though a successful project is accomplished.

Training is so important in implementation process. Mandatory training takes part in all of these case projects. Nevertheless, these are usually realized as insufficient by project team members. One of the observed weaknesses of trainings is the absence of top management. Still they provide support for projects; they usually are the last people in organization to gain knowledge of system. All these project participants are not satisfied with training. Therefore, this shows the necessity of training approach, methods or quality to be discussed. There should be some improvements in quality or time of training

The project plans cover training and one or two-day module trainings, which take about 10 days in total, are arranged for group of key users. However, it seems that training is one of the hard areas of project because consultants and employers from two organizations claim their displeasure about trainings. Mainly budgetary effects have influence on training duration. In Turkish economic and business environmental conditions, projects are carried out with limited budgets and human resources. This reality shows its impact on total project process and usage of consultants. However, the quality of trainings and the knowledge process can be analyzed and improved for ERP projects.

Project managers are usually effective in change management. But it is change management which is not professionally held. Change management is the critical part of the project especially as project brings massive change in business operations. However, projects are not carried out as change projects. This results in change necessities and project goals to be misunderstood or underestimated by project team and overall organization. Realizing this situation, the project manager and top managers perform forceful behavior towards project team and employees. This usually illustrates how Turkish organizations and managers conduct change management. Indeed, change management should be taken into account with the concept of organizational culture. However, case projects show that change comes after project implementation with the authoritarian manners of management destroying all other alternatives for employees.

The project team composition has significant effect on redesign of operational procedures. It is important to work with people who have operation knowledge in order to make designed processes realistic and practical in actual business, not only on papers or deliverables. Taking into account that employees do not want to work much or have workload to have accurate system data, benefits of the system for both organization and employees should be made clear. The employees should realize this situation as win-win case.

Two different cases demonstrates that project team members do not have experiences on project work even though they are well experienced about their jobs. Their talent for information technology affect training period as well. In most of the projects technical

analysts are required to be trained internally or new experienced technical engineers are employed. Therefore, consultants play a critical role in project with their guidance both in technical and functional issues about the program and configuration of program to meet customer expectations. They, on the other hand, act as business analyst and redesign engineers to create newly business procedures. Consequently, their qualification and experience both in program training and business analysis is significant for project success.

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Two different cases demonstrates that project team members do not have experiences on project work even though they are well experienced about their jobs. Their talent for information technology affect training period as well. The customers' background knowledge of information technology is another criterion for effective team composition. In most of the projects technical analysts are required to be trained internally or new experienced technical engineers are employed. Therefore, consultants play a critical role in project with their guidance both in technical and functional issues about the program and configuration of program to meet customer expectations. They, on the other hand, act as business analyst and redesign engineers to create newly business procedures. Consequently, their qualification and experience both in program training and business analysis is significant for project success.

Decision process before choosing the right ERP package for implementation is important. This process should handle carefully before execution of project. It is clear that ERP packages can not cover all of the unique business requirements. However the success of project necessitates the best match package to be selected. The doubt about ERP package brings problems for project implementation procedures.

Most importantly, ERP systems should be considered as live systems which can be improved and changed after time with the requirements of real operations. Realization of this makes system ongoing success persistent as system develops overtime.

Further research on project assessment is necessary for contribution to ERP concept. Many implementation projects are being conducted but there is lack in the post-implementation reviews. Projects are not assessed and project failures can not be identified. Furthermore, most of the large-size organizations in Turkey have already implemented ERP systems. Therefore, ERP systems for medium-size organizations, these organizations' requirements and changes that they bring into ERP market could be analyzed.

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THE ROLE OF PERFORMANCE MEASUREMENT SYSTEM IN BUILDING TRUST BETWEEN CENTRAL GOVERNMENT, LOCAL GOVERNMENT AND ITS CONSTITUENTS

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Abstract

The widespread adoption of decentralization throughout the world is based on a common belief that decentralization is considered to have the potential to improve the performance of the public sector and will result in stronger municipalities. However, some argue that the assertion on decentralization's potential to improve performance may be applicable to the developed countries, but it is not the case in developing countries.

Inability centralized planning in promoting equal development and financial difficulty have been quoted as main reasons for decentralization. However, along with the autonomy in planning, resource allocation and implementation comes heavier burden of newly delegated responsibilities. Cost cutting and improving the efficiency of programs became the major concerns for local governments that many of them decided to adopt performance measurement in the hope that it might contribute to the improvement of their financial status.

Recent study shows an increasing number of government institutions have reformed their performance measurement system to address the decentralization process. As every approach has its strengths and weaknesses, learning the experience of Indonesian government would provide a valuable lesson on the role of performance measurement system in the decentralization.

INTRODUCTION

This paper focuses on one of the current issue areas in public management – fiscal decentralization and performance measurement system. Although there are numerous studies on fiscal decentralization and performance measurement system in government institution, only a few studies done on the role of performance measurement in the decentralization in developing countries. This research paper uses the case study to study performance measurement.

Learning from past experience is one way to improve performance. However, governments do not necessarily possess the capacity to readily learn from their previous success and failures. Success story or even failure story could help to build and sharpen the capacity. The success story of performance measurement in a developed country might provide a reference for the developing countries to evaluate what went wrong and improve their performance in the future. On the other hand, the case study of some developing countries, even the failure story, would provide some insight for other countries not to repeat the same mistake. It would take time and effort, even some failure experiences before developing countries could successfully implement performance measurement system. Nevertheless, experience from other countries could help one country to shorten the time, minimize the effort and increase the successful rate in implementing performance measurement system.

The paper is structured along the research questions. Most of the theory is embedded in the first section of the literature review. Next, we shortly describe the methodology of the research. The next section is going to discuss decentralization process and performance measurement of Indonesian government. The fourth section describes analysis of the case study through the decentralization time frame. Finally, there is a conclusion with some implications for practice and theory.

LITERATURE REVIEW

Inability centralized planning in promoting adequate and equal development, together with financial difficulties caused by growing service demands and under-performing economies resulted in mounting budget deficit. It had led to emerging decentralization process worldwide (Smoke, 2006)

Decentralization is the transfer of authority, responsibilities and resources to lower levels of government (Dillinger, 1994). Recent decentralization reforms also substantially imply a transformation of accountability chains between central government, local governments, and the community, in which it crucially depends on the mechanism to replace central management with control over government affairs at the local level by the constituents (Blair, 2000; Manor, 1998; Crook and Manor, 2000, World Bank, 1995; Agrawal and Ribot, 1999). Otherwise, decentralization may in fact create incentives to distract public resources from its objective to satisfy individual interest.

The most important pre-condition for the success of decentralization is to establish *local accountability* through effective checks and balances, which implies that the use of local information (the region's performance information) is critically needed. During the early years of decentralization, lack of *local accountability* seems very common since there is lack of incentive or accountability pressures imposed on elected officials to implement policies in the public interest, due to lack of proper information, low education, or other reasons (Aziz, 2008).

Public sector reforms regularly incorporate a performance measurement element (Pollitt and Bouckaert, 2004). Public Sector reform focuses on how to balance resource with targets while considering cost efficiency, with performance measurement as its core. Performance measurement is intended to produce objective, relevant and precise performance information to answer the accountability demands, which would not only reduce the need for arbitrary judgment but also make it easier to scrutinize performance (Hatry, 1999). One of the main reasons for inefficient, ineffective and low productivity in public sector in the developing countries is lack of transparency and accountability in government organization, which could be caused by many reasons such as incompetent human capital, inadequate information technology/infrastructure, and vested political interest. The condition is aggravated by the fact that among the information available, there is still lack of relevant information for telling success from failure and for decision making. The information is by and large provided by the performance measurement system.

The existing theoretical and applied literature offers some arguments in favor of decentralization, which highlight the important of performance measurement. Decentralization is still enthusiastically praised as an effective remedy in the reform of governance systems, particularly in developing countries (Dillinger, 1994). A principle of good governance has the following characteristics of devolving centralization power with decentralization on the basis of subsidiarity¹, public participation in every decision-making

¹ Subsidiarity suggests that a local government seeking to achieve self-reliance and should not only rely on the central government (Michael H. Schuman, 2000, pp. 125, 128)

process at any level of government, efficient and effective government accounted transparently, and cooperation among government institutions and entities of community (Legowo, 2003). Some scholars argue that decentralization enhances the public sector's political accountability, legitimacy and responsiveness (Wagner, 1983; Oates, 1993). Seabright (1996) argues that accountability is considered more significant at the local level compared to the national level, since citizens could directly elect the governments based on their performance. Besley and Burgess (2001) suggest that both transparency and participation increase the political cost of not responding, thus creating incentives for the government to be more responsive. In this perspective performance measurement system could align incentives in a political system by providing relevant information, as Hatry (1999) states that a successful performance measurement system could be measured in terms of the quality of the discussion, the transparency of the information, the meaningfulness of that information to key stakeholders, and how it is used in the decision-making process.

Decentralization enhances the public sector's responsiveness, effectiveness, and efficiency in service delivery (Smoke, 2006). Furthermore, decentralization is assumed to enhance competition among jurisdictions to provide public services (Tiebout, 1956). In this perspective, performance measurement system could accommodate benchmarking process. However, some empirical evidences from developing countries such as Colombia, West Bengal, Brazil Eastern and Central Europe suggest the opposite result or at least achieve little in improving service delivery (Litvack, Ahmad, and Bird, 1998; Crook and Sverrisson, 1999; Mitlin, 2000). As some studies concluded, the implementation of any system in developing country government is more difficult compare to the one in the developed countries since they have to face the capacity constraints, limited technology, corruption and vested interest. The developing country government should get the basics rights, before attempting to introduce complex practices (Athukorala, 2003). In implementing decentralization and developing performance measurement system, it is important to consider the organizational insight and contextual factors. Instead of designing a one-size-fits-all system based on the best practices in the public sector, government should consider the differences between organizations (Dooren, 2005).

Nevertheless, most of the existing theoretical and empirical research has dealt with the impact of decentralization on the improvement of performance in local government. This paper will try to complement the unfinished research agenda on the varying patterns of local performance measurement systems to the new institutional environment created by decentralization policies, e.g. the role performance measurement in the relation between central government, local government and its constituents.

METHODOLOGY

This paper is based on the research conducted on performance measurement system of Indonesia government. The research approach adopted had a number of distinct stages. The data is collected through documentary sources, observation and interviews. The analysis is primarily based on a documentary data, which consist of laws, journals, articles, instruction manuals, financial and performance reports, and other documents regarding decentralization and performance measurement.

After reviewing the literature in the area to enable some prior expectations to be established, interviews were conducted on a totally informal and unstructured basis and not recorded verbatim. This process was chosen to allow respondents to talk freely and in an unconstrained manner to ensure that all issues. The interviews were conducted with top management within the Ministry of Finance of Indonesia, since it is argued that the Ministry

of Finance is most concerned with the government reform and has been one of the change agents in the government.

In addition to the documentary study and interview, the writer has had the opportunity to participate and observe the meetings in the Ministry of Finance during a period of more than 3 years. The observations have, above all, helped to better understand and interpret the data from the documents.

DECENTRALIZATION PROCESS AND PERFORMANCE MEASUREMENT SYSTEM IN INDONESIA

Since the political reform took place in 1998, there has been an increasing demand for more transparency and accountability. People demanded government to be accountable for every governmental activity and result. Before the reform took place, it was difficult for public to assess performance of government institution because it did not have any system to measure the efficiency and effectiveness of management in generating its intended result. The performance was only measured by financial accountability system, which describes budget realization of government institution. Accordingly, the performance of government institution was deteriorated as there was no measurement system to watch over it. It caused government to lose the public trust. This situation has made performance measurement become a crucial issue, more than ever, to be addressed.

There was no other way for government to gain public trust but to initiate performance management reform in 1999. To anticipate the challenge of the political reform, former President Habibie issued Presidential Decree number 7 Year 1999 on performance accountability in government institution². This decree requires every government institution to prepare strategic planning for five years and evaluates its achievement on Performance Evaluation Report at the end of fiscal year. Performance Evaluation Report was written based on evaluation of organization achievement by comparing plan with actual result in term of five indicators: input, output, outcome, benefit and impact. The performance report will be evaluated by Financial and Development Supervisory Board, an internal auditor of government.

Decentralization is another outcome of the reform, which aim to promote implementation of good governance, by bringing key decisions closer to the public. The framework for decentralization of local government is based on the promulgation of Law 22 of 1999³ concerning Regional Administration and Law 25 of 1999⁴ concerning the Financial Balance between central government and the regions. The laws have led to major changes in civil service organization and its ways of working, by introducing separation of responsibilities between central, provincial and municipality government. Decentralization in Indonesia follows the unitary system. District or municipalities is responsible for delivering public services, Provincial Government is responsible for defining Standard of Minimum Public Services and Central Government holds the authority to define related policies. With mayors and district heads now selected directly by citizen rather than by local assemblies, local governments have become accountable to the local population in a fundamentally new way. One significant change was that the implementation of a single block grant, known as the General Purpose Fund (Dana Alokasi Umum, or DAU) in January 2001, which would provide autonomy for local government in utilizing the fund (Alm and Bahl 1999: 1–4),

² The term *government institution* refers to all government organizations including line ministry, which would assist President in implementing his policy.

³ Law 22 of 1999 has been replaced by Law 32 Year 2004

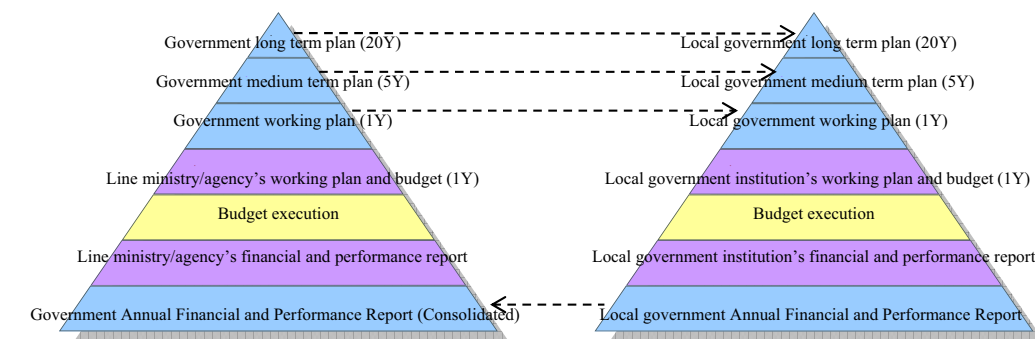
⁴ Law 25 of 1999 has been replaced by Law 33 Year 2004

As part of the effort to provide operational regulations to implement the local autonomy program, which came into effect on January 1, 2001, the central government passed government regulation⁵ number 105 Year 2000. The promulgation of the government regulation represented a milestone for local government financial management systems, because it introduced new budgeting concepts and financial reporting requirements that were significantly different from that which already existed. It also appears that some ideas from the private sector have been transferred into the local government sector. In 2005, government issued government regulation Number 58 Year 2005 to replace the previous mentioned regulation. However, both government regulations do not regulate the performance measurement or reporting.

The government financial management laws in Indonesia were still based on the outdated Dutch Law originated from the colonial era. Realizing the problem in legal framework, government issued Law number 17 year 2003 about State Finance, Law number 1 year 2004 about State Treasury, Law number 15 year 2004 about Audit on State Financial Management and Accountability and Law number 25 Year 2004 on National Development Planning System. According to Law number 25 Year 2004, government should prepare nationwide long-term plan for 20 years. Together with fiscal outlook data, government prepares the medium-term plan for 5 years, which will become a basis for government institutions to prepare their strategic plan. For each fiscal year, government will prepare work plan based on the nationwide medium-term plan. Based on their strategic plan and taking government work plan into consideration, government institutions will prepare their work plan. The process is similar to those of the local governments. They should prepare long-term plan for 20 years based on nation-wide long term plan. Local government prepares the medium-term plan for 5 years based on local government long term plan, nation-wide medium-term plan and standard for minimum service. It explains the planned vision, mission and program of elected governor/mayor. The medium-term plan would become a basis for local government institutions to prepare their strategic plan (stated in Law number 25 Year 2004 and Government Regulation number 58 Year 2005). For each fiscal year, local government will prepare work plan based on the local government medium-term plan and central government work plan. Local government work plan describe economic framework, development priority, work plan and funding plan. Based on their strategic plan and taking local government work plan into consideration, local government institutions will prepare their work plan. Strategic planning consists of description of vision, mission, strategy, goal, objective, policy, program and activity of organization. Strategic planning explains expected achievement within five years considering organization's capability, opportunity and problem.

⁵ In Indonesia, Law is the highest law product below the Constitution since it is formulated by the Parliament and president. Government Regulation is a lower level of law product compare to Law. Government Regulation is formulated by president with approval from the parliament. Presidential decree, issued by President, has lower law power compare to the above law product.

Figure 1 The reformed strategic management framework



Note: Performance measurement system is still in the development process

| | |
|--|--|
| | Prepared by Government (Central government: Ministry of Finance and/or Chief of National Development Planning Agency; Local government: Governor/Mayor) |
| | Prepared by line ministry/agency/local government institution |
| | Conducted and recorded by line ministry/agency/local government institution and Government (Ministry of Finance/local government institution in charge of treasury function) |

To execute strategic planning, government institutions need budget that consist of plan and resource allocation. Budgeting process consisted of three phases of submission (budget proposal), approval (budget) and implementation (Budget Execution Document). Every year government institution prepared budget proposal. It was a bottom-up process, which started from the work unit until it was compiled into organization-level budget proposal. With information on temporary budget limit, government institutions adjust their work plan into work plan and budget. Draft for central/local government Budget would be prepared based on compilation of government institutions' work plan and budget. President/governor/mayor will discuss this draft with the central/local parliament to result in central/local government Budget. The central/local government Budget would become a basis for adjustment in government institutions' work plan and budget. Budget would become a basis for operational activities since every resource used in the operation must be authorized by budget. Each government institutions will prepare budget execution document as a basis to put work plan and budget into implementation.

At the end of every fiscal year, government institution has to prepare Accountability Report and Performance Evaluation Report on its annual achievement. According to the new Government Accounting Standard enacted in 2003, Accountability Report should include three main reports of Budget Realization Statement, Balance Sheet and Cash Flow Statement. Budget Realization Statement compares budget with actual result in term of currency. Balance Sheet lists government asset, liability and equity. Cash Flow Statement illustrates government cash flow from operating activity, investing activity and financing activity.

Recently, government has issued Government Regulation Number 8 Year 2006 on Financial and Performance Reporting on Government Institutions to replace the Presidential Decree number 7 Year 1999. The performance measurement system under the presidential decree has numbers of issues which hinder the efficient and effective measurement of government performance. Performance measurement according to the new regulation is basically simplified into output and outcome basis. Currently, government is drafting the presidential decree to translate the regulation into a more detail regulation. It is stated in the government regulation that ministry/chief of institution/governor/mayor is responsible from policy point of view on the organization's performance achievement, while working unit manager is responsible on performance achievement

in the form of product and/or service of the unit. Annual performance report should include description on activity output and performance indicator on each program.

THE ROLE OF PERFORMANCE MEASUREMENT IN DECENTRALIZATION

It has been 9 years since decentralization took place in Indonesia, which was followed by the implementation of performance measurement system. As every approach has its strengths and weaknesses, learning the experience of Indonesian government could provide a valuable lesson on the role of performance measurement system in the decentralization process. The case study is analyzed based on the decentralization timeframe, which influence the role of performance measurement in the relation between local government and its constituents.

1. On-going decentralization process

On-going decentralization process consists of two phases, which are pre-decentralization process (before 1999) and transition period (1999-present). Each phase is discussed in the following section.

a. Pre-decentralization period

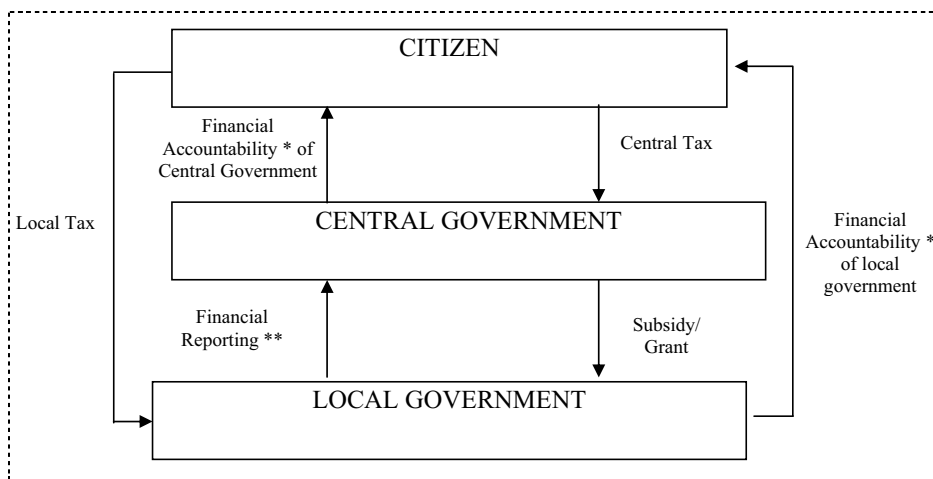
The move for decentralization in Indonesia has come to surface from the 1980s and 1990s. Central government has been reluctant to devolve greater authority to the local government. There are several reasons accountable for it such as heterogeneity of people in Indonesia that need a more centralized system, central government's view on local government's lack of capacity and willingness to manage their affairs independently, alignment of local government to the national development plan (Rukmo, 1998) and central government's unwillingness to relinquish control of development funds to the regions (Silver, Aziz, Schroeder, 2001). The actual of decentralization came in effect only in 1999, thank to the economic and political crisis that hit Indonesia in 1997 (Forrester and May 1999; MacAndrews 1986; Walker 1991; Leigland 1993; Ranis and Stewart 1994).

As shown in **Figure 2**, before decentralization, the division of central government and local government was basically a structural model of government, focusing on national unity and control (Rukmo, 1998). The decision making was concentrated at the central government. The concept of decentralization had been introduced even during the Dutch Colonial, Soekarno⁶ and Soeharto⁷ regime but the decentralization concept at that period meant the implementation of service delivery at the local level only, without distribution of decision-making authority to the local government (Crane, 1995; Devas, 1997; Walker, 1990). Although there was Law on Regional Autonomy issued in 1974 to devolve authority to the province government, it was difficult for province government to carry out the authority since it took time for the central government to issue the implementation provision. Local government was viewed as a subordinate of central government and was provided with subsidy/grant to finance their operation. Local governments could not sufficiently finance their own operation since Indonesia is one of the most centralized tax systems in the world (Ma 1996: 29) that more than 70% of all regional government revenues come from central government's intergovernmental financial transfers, which has been used as a pressure to address national development objectives (Silver, Aziz, Schroeder, 2001). The central government had primary responsibility for administering, setting tax rates and bases for all central and provincial taxes. The central government raised about 93 percent of total tax revenues of all governments, while provinces and district raised about 5 and 2 percent of total tax revenue of all levels of government (Ahmad and Krelove, 1999).

⁶ First president of Indonesia (after independence)

⁷ Second president of Indonesia, who ruled for 32 years

Figure 2 The relation between local government and its constituents in before decentralization and implementation of performance measurement system



*) Financial accountability consisted of Budget Realization Report only.

**) Financial reporting consisted of Budget Realization Report only

The accountability process was conducted by means of financial report (budget execution report) by the central government to the citizen, who is represented by the parliament and those of local government to the local citizen, who is represented by local parliament. During this phase, basically, central government and local government did not implement any performance measurement system. One of the reasons was authoritarian form of government in Indonesia, which suppressed the public demand for performance accountability. Furthermore, the mind set in government was still focus on input. Government prepared budget proposal based on resource needs and they would be held accountable based on resource spent on program. Government institutions were never being held accountable for output.

b. Transition period

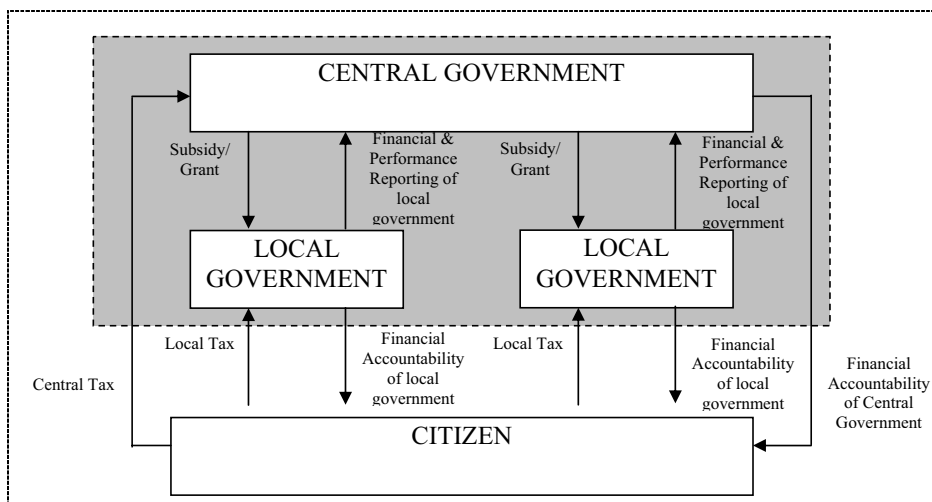
The political reform in 1998 followed with the enactment of Law 22 Year 1999, on regional autonomy, and Law 25 Year 1999 on the financial balance between central government and the regions, marked the new era of decentralization, which redefined the relationship between the central, provincial and local government. The laws transfer a wide range of public service delivery functions to the regions and strengthen the authority of elected regional councils. The law determines the local level (provincial and district) has responsibility for all governmental matters except in five areas: foreign affairs, defense and security, justice, religion, monetary and fiscal affairs.

As shown in **Figure 3**, decentralization highlights the importance of performance measurement system as control and governance tools to stakeholders, mainly in this case, the central government. Indonesia implemented unitary system and began introducing performance measurement system just after decentralization trend emerged. Indonesia government use centralized policy by introducing the mandatory performance measurement system through the regulation. Before decentralization, central government held a complete control on the authority and resource, which were transferred to local government after the decentralization. Since a *unitary state* is governed constitutionally as one single unit and central government retains the

principal right to recall such delegated power, it is important that central government could monitor local government's performance and align their direction to those of central government⁸. For that purpose, central government has been urging local government to implement performance measurement system to provide a complete picture of local government performance.

As control and governance tool, performance measurement system of local government should be integrated to government planning, budgeting, treasury and accounting system, as articulated in the Government Regulation number 8 Year 2006. Strategic planning should consider resource allocation, while resource allocation should consider targeted output and outcome. Performance measurement system will inform the progress of the program to plan for the following year. Another primary function of performance measurement involves the maintenance of fiscal stewardship through an effective budget process. Because the budget is the basis for resource allocation decisions, government has strengthened the link between resources and performance in budget justifications by introducing performance-based budgeting concept through government regulation number 21 dated august 5, 2004. In performance-based budgeting concept, government institutions have to prepare information on output and cost of planned activities in proposing budget plan. Estimated output and cost would become a basis for budget allocation and forward estimate⁹ for the designated program.

Figure 3 The relation between local government and its constituents in the framework of performance measurement system (Control)



The implementation of performance measurement in Indonesia was based on a presidential decree. Its purpose was to report government performance in order to improve government transparency and accountability to public. In addition to financial report regarding the utilization of subsidy/grant, the local government has to submit

⁸ For example, based on Law number 25 Year 2004, the Local government has to align to nation-wide plan to provide cohesion to achieve national objectives.

⁹ Forward estimate is cost estimation to carry on the project or activities to the next fiscal year. It is one element of Medium-term Expenditure Framework. It should be submitted in budget proposal for the current fiscal year. It would become a basis in preparing budget proposal for the next fiscal year.

performance report every year as required by the regulation, which would be evaluated by government internal auditor (Financial and Development Supervisory Board). However, the accountability of performance was mainly based on financial statement since the mind set in government is still focus on input. It has crowned Financial Accountability Report as a very important report for government institutions, while Performance Evaluation Report was only considered as a compulsory end-of-year job. Furthermore, the performance measurement system was too complicated and designed without carefully considering the organization capacity. As a result, the focus of performance report of local government is mainly for the consumption of central government. The public is still 'illiterate' in grasping the content of the performance report, and it might take time to educate and build their awareness on their 'right to know' as citizen.

2. Future chapter

Future chapter of decentralization process should consists of two phases, which are publicly-accountable local government and trustworthy relationship among entities. These two phases would take place after the new performance measurement system successfully implemented. Each phase is discussed in the following section.

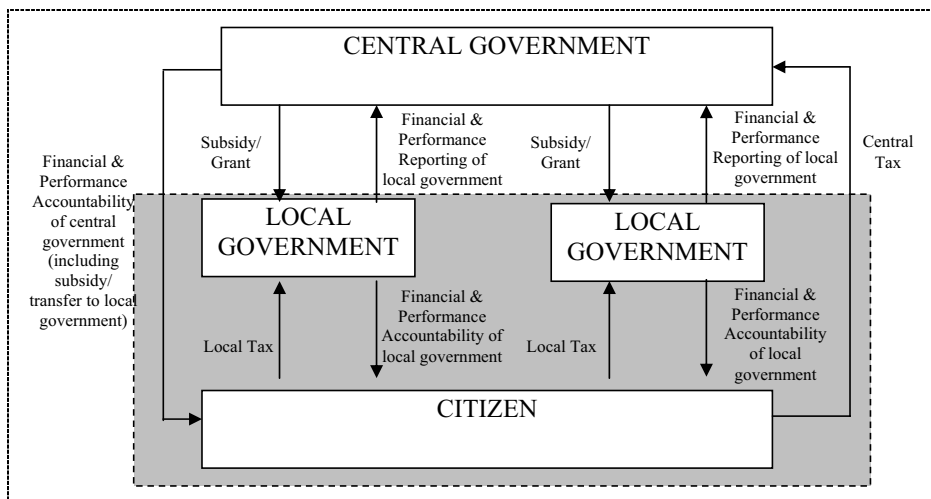
a. Publicly-accountable local government

The autonomy should be complemented with accountability. As decentralization transfers the allocation function of public goods/service to local governments, they should be responsive and responsible to their constituents, and those constituents to be fully informed about the consequences of their decisions. This is the basic principle of accountability, which is essential both for value for money (economic efficiency) and democratic representation.

The principle highlight the importance of own-tax bases of local governments and discretion to determine their own tax rates, rather than financing through grants or revenue sharing with higher levels of government. Local residents are responsible for paying for local services, which in turn requires that local authorities can set some tax rates (economic accountability). There must be a balance between the provision of local public goods and the tax borne by local residents. However, most of the case, the own-tax revenue could not cover the soaring operation expense, that central government has to provide subsidy/grant to local government to cover the shortage in expenses. As a consequence, the local government should be accountable for the level of performance to their stakeholders, either to the public for the amount of tax or the central government for the amount of subsidy/grant.

In principle, it is perfectly possible for a local government to be heavily dependent on central transfers and still be fully accountable—to its citizens and/or the central government, depending on circumstances. Nevertheless, local government should also keep in mind that high level of fiscal imbalance, as local government heavily dependent on central government's subsidy/grant, could reduce local autonomy and accountability, as shown in UK case (Bird and Tarasov, 2004; Watt, 2004; Stegarescu, 2005). It would lead to the central government in the direction of attempting centralized micro-management under comprehensive performance management systems (Watt, 2006).

Figure 4 The relation between local government and its constituents in the framework of performance measurement system (Accountability)



As shown in **Figure 4**, performance measurement system could become an accountability tool of local government to its constituents. As the public is becoming more concern with the local governments' performance, local governments have to be transparent to the public on their performance. There should be a clear legal framework of accountability, with respect to responsible entity, reporting form, time, and so on (administrative accountability). At this phase, local government should have published financial and performance report to their constituents. As Indonesian government is preparing to implement a new performance measurement system, it might take time before local government could measure their performance and be accountable for it. Once the local governments could measure their performance appropriately, they would prepare performance accountability report accordingly, either for central government or for citizen. Central government should summarize and consolidate the performance report of local government, especially performance related to subsidy/grant since it is financed by the central government. Furthermore, central government could reevaluate the scope for further devolution of control to local governments for taxes to provide local governments with greater own-source revenues and improve their financial condition.

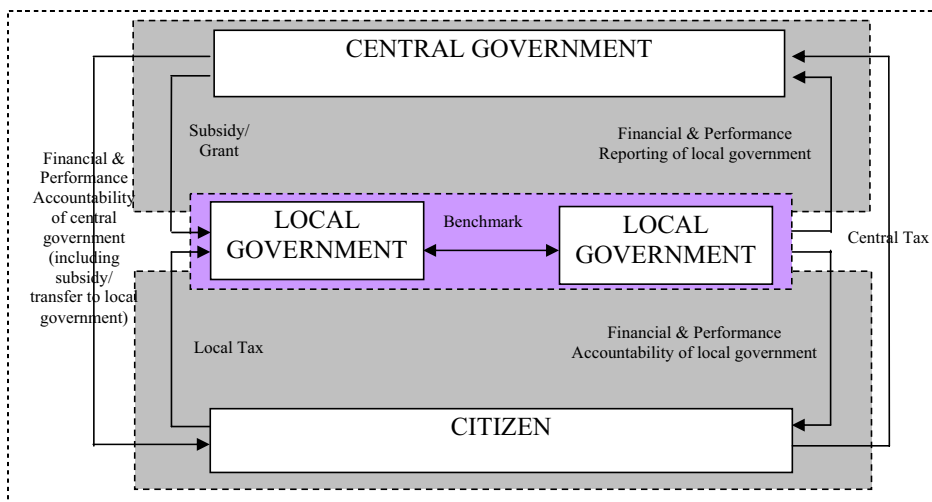
One of the requirements to improve performance measurement system in Indonesia, as required by the State Finance Law, is the employment of the accrual based system for central government and local government. The implementation of accrual based system would improve the performance measurement system in term of cost/efficiency measurement. The uniformity in the performance measurement and accounting system would help the central government to monitor the performance of local government and provide more comparable information for benchmarking in the future.

b. Trustworthy relationship among entities

Evaluation is the usual reason for measuring performance. Often, organizations are reluctant to report their performance because they are anxious about how the performance data is utilized to punish bad performance. It is why open communication

and trust are important to convince the organizations that the purpose of evaluation is on performance improvement.

Figure 5 The relation between local government and its constituents in the framework of performance measurement system (Communication)



As shown in **Figure 5**, performance measurement system accommodates communication between central government and local government, local government and its constituents, among local governments. It would provide information on performance to higher level government and, based on the performance information, higher level government would provide direct or indirect feedback (through policy in revenue sharing, subsidy, grant, etc) to the lower level of government. As the demand for public goods/service is diverse, the prescribed role of decentralization is in the allocation function of public goods/service to local government (Smoke, 2006). Decentralization draws local government closer to its constituents as local government is given more authority to decide what kind of product/service to provide. Through performance measurement system, local governments could communicate the product/service that they have provided and the level of performance. On the other hand, the constituents could learn the 'value for money' that they have received and provide feedback based on the result.

Performance measurement could help local government to identify, recognize and share best practice since standard or benchmark is needed as a point of reference (Robert Simons, 2000). The key success factor for performance measurement in the longer term is the utilization of information by its stakeholder. Local government could use performance information for the benefit of joint learning, search for best practice to improve their performance and make correction effort. When local governments see the benefit of performance measurement in sharing information and identifying best practices, they will consider performance measurement as important management tool. Local governments in Indonesia should strive to reach this stage.

CONCLUSION

The widespread adoption of decentralization throughout the world is based on a common belief that decentralization is considered to have the potential to improve the performance of the public sector and will result in stronger municipalities. However, as some studies concluded, the implementation of any system in developing country government is more difficult to compare to the one in the developed countries since they have to face the capacity constraints, limited technology, corruption and vested interest (Athukorala, 2003).

Authoritarian form of central government in Indonesia had been reluctant to devolve greater authority to the local government, mainly due to central government's view on local government's lack of capacity, central government's vision to align local government to the national development plan (Rukmo, 1998) and central government's unwillingness to relinquish control of development funds to the regions (Silver, Aziz, Schroeder, 2001). In addition, the public is still unaware of their 'right to know' as citizen and 'illiterate' in grasping the content of any government report. As a result, there was latent distrust between central government, local government and the public, which finally came to surface during the economic and political crisis that hit Indonesia in 1997.

As the most important pre-condition for the success of decentralization is to establish *local accountability* through effective checks and balances, the utilization of local information (the region's performance information) is critically needed. As indicate in the case study, the role of performance measurement system change as the decentralization advances, from the role as control tool to central government, accountability tool to its constituents, to communication means between entities. As a result, the performance measurement system could accelerate the process of decentralization and revitalize the local governments. However, performance measurement is one, but will not be the only, factor in successful decentralization process or it is not a solution for every problem and challenge to effective decentralization process. There are many other problems, which relate to the ineffectiveness of management practice and decentralization process in the public sector that cannot be solved by performance measurement alone. It does not replace the need for political goodwill, adequate system, or human resource management. Therefore emphasizing only on performance measurement system could be misleading and led to undesirable behavior that detracts from performance.

The reform is in process and all the main issues are on schedule, but there is still a big question mark on successful implementation of the performance measurement system in Indonesian local government. Government institutions in Indonesia are one step ahead from their past, heading to performing government. The reform process has brought many progresses, but there are more to improve. The decentralization and new performance measurement system is on the way for its implementation. Developing new performance measurement system and utilization of performance information is the future issues in Indonesian government. Successful implementation of the new system is still an ongoing question that needs to be tested. The successful implementation of performance management would become a powerful force in creating an efficient and effective management system in local governments. Hence, it will improve government accountability to the public and help government to regain public trust.

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SCIENTIFIC AND TECHNICAL POTENTIAL: UKRAINE AND THE WORLD

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Abstract

The main scientific goal of paper is researching of theoretical and practical problems of scientific and technical potential of Ukraine and other countries in the aspect of globalization. The paper reveals analysis of approaches of evaluation of scientific and technical potential on different levels, comparing Romania, Hungary and Ukraine by the selected indicators which recognized of knowledge economy and define on scientific and technical potential, structural changes in economy that influenced on changes in scientific and technical development of Ukraine, technological and personnel components. Authors assert that domestic industry of high technologies can be all-sufficient for terms at least maintenance of existent scientific and technical potential and productions capacities and their update.

Key words: *scientific and technical potential, variables of knowledge-economy system, structural changes, high tech industries, science intensiveness*

Introduction

The economy stagnation of Ukraine during 90th, markets reforms of the numerous governments directed on the decision of mainly tactical tasks resulted in disparity and unclaimedness of scientific and technical potential. The potential was reached in the inheritance from Soviet Union and was formed during half of century and lost its disparity and unclaimedness in the condition of national economy. Uninvolved of scientific and technical potential of country during long period, which can be compared to atrophy of muscles of sportsman, resulted in his disparity to the requirements of global economy.

Strengthening of global competition next to the loss of considerable world markets share by domestic enterprises creates the considerable obstacles on the way of the use by them present possibilities of development, potentials. The touch upon the issue of efficiency improvement of production acquire in this situation of the special value, achievement of high economic indicators at the rational use of resources, improvement of investment attractiveness and increase of competitiveness. For the decision of these tasks the estimation of scientific and technical potential is needed as basic strategic force which provides competitiveness, with the purpose of subsequent effective his use.

It is possible confidently to assert about a presence in Ukraine of considerable scientific and technical potential, however about his realization during the last 15 years - heavy.

Problem of neighbours of countries for socialistic camp and former Soviet republics certain in relation to achieving alike or were alike. By the difference of Ukraine from Byelorussia and Russia in relation to realization of scientific and technical potentials there is the speed-up-evolutional way of development of Byelorussia due to the successful economic policy of country leadership in relation to the maintenance and increase of potential and revolutional for Russia due to the change of the world state of affairs on energy resources and due to super-profits got from sale of energy resources. Romania and Hungary unlike Ukraine did not have not internal markets which would require forming in the countries of powerful scientific and technical spheres, and not neighbor-countries, which would be interested at

development of their potentials. In a period 1950-1990th the satisfactory rates of development of their economies were achieved due to the use of scientific and technical achievements of Soviet Union. Last two decades countries form scientific and technical potentials in the collaboration with the countries of Western Europe. However much competition in a scientific and technical sphere with the countries of South-east Asia is complicated for them as well as for Ukraine.

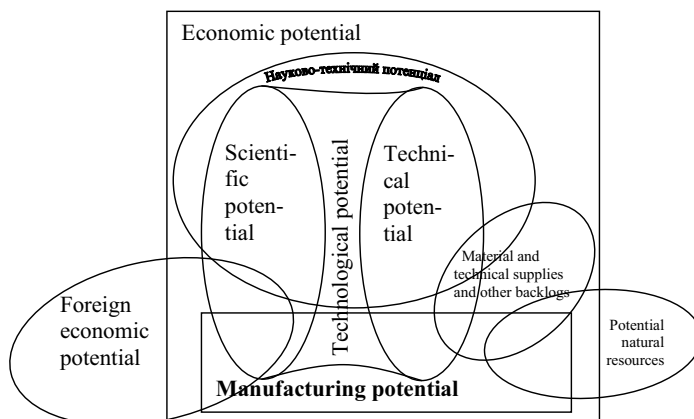
Research results

Approaches of determination of scientific and technical potential

Determine scientific and technical potential as the generalized description of level of development of science, engineering business, technique in a country, and also possibilities and resources which has in the order society for the decision of scientific and technical tasks [1, 2, 3].

In scientific literature exists universally recognizing of scientific and technical potential as inalienable and decision factor of economic development, his connection is marked with economic, social and other potentials of country. We present intercommunication of potentials and place of scientific and technical potential as interlacing of different potentials with the own degree of interinfluence (fig. 1 [4, 5] it is adapted by authors).

Fig. 1. Aggregate of potentials and place of scientific and technical potential



There are a few conceptions of scientific and technical potential. Scientific and technical potential, which wider than other, is especially marked in first from them, co-operates with other potentials of society. The use of the noted potential considerably influences on scientific and technical transformation of production, instrumental in growth of economy of country.

The second conception leans against experience of entire countries of world, which testifies, what only in mutual accordance, projected and operating: technological processes, apparatus-machine facilities, the elements of organizationally-administrative forms of conduct and providing of productions can provide integrity of this technological system, create terms for including of the combined labour potential in the complement of productive forces, to form terms for the effective use of social factors of production, complete opening of creative potential of personnel, that uses facilities of labour are marked [6, p. 19].

Analysis of approaches in relation to determination of scientific and technical potential in robots domestic and oversea authors resulted at table 1.

Table 1. Classification of definitions of „scientific and technical potential”

| Author | Definition content | Source |
|----------------|---|--|
| U.M. Kanygin | aggregate of factors (intellectual and material), which determine a level, terms of creation and scales of distribution of the new technological systems in public production, which includes science, education and technical potential of production | Каныгин Ю.М. Научно-технический потенциал: проблемы накопления и использования. – Новосибирск: Наука, Сибирское отделение, 1974. - 254 с. |
| P.A. Kulvets | aggregate of economic resources (accumulated funds) which has in the order society for scientific and technical activity, that respond to request economic laws and intended for creation new and the improved products, intensive development of production and providing on this basis of change of character of labour, increase of efficiency of public production | Кульвец П.А. Научно-технический потенциал : Сущность, оценка, эффективность использ. : учеб. пособие / П. А. Кульвец. - Вильнюс: МВССО ЛитССР, 1980. - 55 с. |
| G.M. Dobrov | combined ability of scitech separate country or group of countries, to work out problems of scientific and technical development. This ability is provided by the presence of the properly organized resources (skilled, material and technical, informatively-technical, methodical) in their natural or economic measuring | Научно-технический потенциал: структура, динамика, эффективность / [Добров Г.М., Тонкаль В.Е., Савельев А.А. и др.] ; отв. ред. В.Е. Тонкаль, Г.М. Добров. – К.: Наук. Думка, 1987. – с. 346 |
| V.U. Budavei | organic unity of scientific and technical potentials... In scientific and technical potential results are included only those types of scientific activity, which are direct-coupled with creation of new technique, development of new scientific and technical projects and programs | Будавей Ю.В. Долгосрочные народнохозяйственные программы. – М. : Мысль, 1980. – 207 с. |
| L.S. Blyakhman | result of R&Ds which concerns by an amount and quality of scientific and technical information geared-up for production application in this country, to industry or on an enterprise, and possibilities of its effective use. Potential is measured by a project and the planned effect of the completed R&D, foremost, openings, inventions and rationalizations suggestions | Бляхман Л. С. Экономика, организация управления и планирование научно-технического прогресса [текст] / Л.С. Бляхман. – М. : Высш. школа, 1991. - 288 с. - ISBN 5-06-000592-5 |
| V.I. Gromeka | unity and co-operation scientific, educational, administrative and the modernized part of technical potential | Громека В.И. США: научно-технический потенциал. – М.: Мысль, 1977. – 245 с. (<i>Nauchno-tehnicheskii potentsial (U.S.A.: Scientific and Technical Potential)</i>) |
| OECD | scientific and technical potential includes resources, which enter science, types of scientific activity and scientific service, scientific products | The Measurement of Scientific and Technical Activities. “Frascati Manual”. – Paris: OECD, 1981. – P. 186. |
| UNESCO | aggregate of present resources, which has in the order country for the scientific openings, inventions and technical innovations, and also for the decision of national and international problems which are pulled out before science and its constituents | Manual of surveying national scientific and technological potential, collection and processing of data. Management of the R&D systems // Sci. policy stud. and doc. and system. – Paris: UNESCO, 1970. - №15. – P. 210 |

Outcoming from the results of research from we consider that scientific and technical potential of E this the system, that includes to the shot, material, financial and informative resources, which has in the order science sphere and technicians which are realized effectively in certain socio-economic and organizational terms.

The most substantial descriptions of scientific and technical potential are here erected to following G scientific and technical potential: 1) as scientific and technical resources are accumulated; 2) as factor by which accumulated scientific and technical resources influence on socio-economic development; 3) as description of the productivity of the accumulated scientific and technical resources.

Researchers distribute scientific and technical potential on the following constituents [7]: material and technical, skilled, informative, organizationally-administrative.

Select the following even estimations of scientific and technical potential: global (estimation of the state of scitech society on the whole), macrolevel (determination of scientific and technical potential of country), meso level (potential of region or region) and microlevel (scientific and technical potential of association, enterprise).

Estimating scientific and technical potential of region other researchers select following his elements [8]: inventions, commodities signs, industrial prototypes, now-how; innovations which can be offered to the use; innovative programs and projects.

Other researchers [9] for the estimation of scientific and technical potential of region recommend to use the following indexes: volume of innovative products after the degree of newness; specific gravity of innovative products in a general production volume %; amount of patents, certificates; amount of underbacks, projects which are developed (in particular by educational establishments) and parameters: inventions, commodities signs, industrial prototypes, now-how; innovations which can be offered to the use; innovative programs and projects, underbacks; management by intellectual property.

In research we will use the estimation of scientific and technical potential on local and macrolevels. For localization we elect the region of East Europe, namely countries which border one to other are acceptable to comparison on their macroeconomic indexes. The requirements are marked to the choice of countries we enter for realization of conclusions in relation to the prospects of their collaboration in a scientific and technical sphere. Romania, Hungary, Ukraine, is such countries.

From beginning – purchased the middle of 90th and got wide distribution in world economic science approach of economy of knowledge, which we equate with scientific and technical progress and intellectual development.

Knowledge economy and its components

The economy development idea on the basis of scientific and technical progress is not new. In particular, a well-known scientist, the academician V. Vernadskiy proposed a noosphere theory at the beginning of XX century. The main place in his theory was taken to human scientific genius as to productive force of the economy growing.

The knowledge-based economy is based on intellectual and human capital, generating and industrial use of knowledges [10]. The term interpretation of knowledge-based economy we can find during the analysis of the world economy evolution stages. The basic of them are: economy of commodity (quality of commodity comes forward the main competitiveness criterion), relations (defines by projects quality), corporate management (by management quality), services (by quality in services), knowledge economy (by quality of intellectual level of worker, personnel, company and country).

A transformation of commodity (and afterwards, service) economy in the knowledge-based economy became possible due to the coincidence in time of the following factors: 1) an

appearance of data processing digital facilities – information technologies; 2) the expansion of spheres of human influence on an external environment; 3) the information computing features are meshed in a network for a rapid information exchange is an information and communication technologies creation.

Methodology of estimation of economy of knowledges, that developed and is used by the experts of the World bank [11], is contained indexes after which can be carried out and conducted certain estimation and comparison of scientific and technical potentials of different countries.

Methodology of determination of degree of development of economy of knowledges of the World bank contains more than 80 structural and quantitative variables after the following groups: economic stimuli and institutional modes, education, innovations and of information and communication technologies [11]. Indexes by which operates methodology is marked allow to carry out the complete estimation of efficiency of economy.

We suggest conducting the comparative analysis of scientific and technical potentials of countries (Ukraine, Romania, Hungary) with application of the following indexes: overall performance of the economy: Human Development Index, Average Annual Gross Domestic Product (GDP) Growth, 1993-97 and 2001-2005 (%), Gross Domestic Product (GDP) Per Capita, 2005 (international current PPP \$), Unemployment Rate (% of total labor force), Employment in Industry (% of total employment); economic regime: Trade as % of GDP, Exports of Goods and Services as % of GDP; innovation system: FDI Outflows as % of GDP, FDI Inflows as % of GDP, Royalty and License Fees Payments (US\$ mil.), Royalty and License Fees Payments (US\$/pop.), Science and Engineering Enrolment Ratio (%), Science Enrolment Ratio (%), Researchers in R&D, Researchers in R&D / Mil. People, Total Expenditure for R&D as % of GDP, Manuf. Trade as % of GDP, Technical Journal Articles, Technical Journal Articles / Mil. People, Availability of Venture Capital (1-7), High-Tech Exports as % of Manuf. Exports; education: Adult Literacy Rate (% age 15 and above), Public Spending on Education as % of GDP, Prof. and Tech. Workers as % of Labor Force; information and communication technology: Total Telephones per 1,000 People, Main Telephone Lines per 1000 People, Mobile Phones per 1,000 People, Computers per 1,000 People, International Internet Bandwidth (bits per person), Internet Users per 1,000 People, ICT Expenditure as % of GDP.

Comparative analysis of scientific and technical potentials: macrolevel

At table 2 presented indexes which determine scientific and technical potential of countries by a complete or partial measure are chosen, which are part of aggregate of indexes for determination of level of economy of knowledge on the methodology developed by the World bank [11].

The knowledge economy estimation methodology uses variables that are measured in different units and on different scales. To calculate aggregate knowledge economy indexes, as well as to simplify graphic representation of countries' comparative performance, we bring all the indicators to the same standard of measurement through the process known as normalization.

The normalization procedure used in the methodology of World Bank is as follows:

1. The actual data (u) is collected from World Bank datasets and international literature for all the variables and countries. Ranks are allocated to countries based on the absolute values (actual data) that describe each and every one of 83 variables (rank u). Countries with the same performance are allocated the same rank. Therefore, the rank equals 1 for a country that performs the best among the countries in our sample on a particular variable (that is, it has the highest score), the rank equals to 2 for a country that performs second best, and so on.
2. The number of countries with worse rank (Nw) is calculated for each country.

3. The following formula is used in order to normalize the scores for every country on every variable according to their ranking and in relation to the total number of countries in the sample (Nc) with available data :

$$\text{Normalized}(u) = 10 \cdot (Nw/Nc) \quad (1)$$

4. The above formula allocates a normalized score from 0 to 10 for each country.

Table 2. Indexes, which influence on scientific and technical potential of countries for Romania, Hungary, Ukraine

| Variable, year | Romania | | Hungary | | Ukraine | |
|---|---------|------------|---------|------------|---------|------------|
| | actual | normalized | actual | normalized | actual | normalized |
| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
| Economic Performance | | | | | | |
| Annual GDP Growth (%), avg 2001-2005 | 5,7 | 7,77 | 4,2 | 4,96 | 7,7 | 8,99 |
| GDP per Capita (in/nal current \$ PPP), 2005 | 9059,9 | 5,9 | 17886,7 | 7,39 | 6848,4 | 4,78 |
| Human Development Index, 2004 | 0,8 | 6,16 | 0,87 | 7,61 | 0,77 | 5,07 |
| Unemployment Rate (% of labor force), 2004 | 8 | 5,5 | 6,1 | 6,75 | 8,6 | 4,5 |
| Employment in Industry (%), 2005 | 30,3 | 8,68 | 32,4 | 9,12 | 24,2 | 6,58 |
| Employment in Services (%), 2005 | 37,5 | 1,84 | 62,6 | 5,96 | 56,4 | 4,74 |
| Economic Regime | | | | | | |
| Trade as % of GDP, 2005 | 76,5 | 4,46 | 134,9 | 8,42 | 106,1 | 7,27 |
| Exports of Goods and Services as % of GDP, 2005 | 33 | 3,77 | 66,4 | 8,41 | 53,5 | 7,39 |
| Innovation System | | | | | | |
| FDI Outflows as % of GDP, 2000-05 | 0 | 0,72 | 1,1 | 7,2 | 0,1 | 4,08 |
| FDI Inflows as % of GDP, 2000-05 | 4,4 | 6,84 | 5,2 | 7,67 | 3,4 | 5,26 |
| Royalty and License Fees Payments (US\$ mil.), 2005 | 173,1 | 6,42 | 1068,5 | 7,92 | 421 | 7,17 |
| Royalty and License Fees Payments (US\$/pop.), 2005 | 8 | 6 | 105,8 | 8,83 | 8,9 | 6,08 |
| Science and Engineering Enrolment Ratio (%), 2005 | 25 | 6,9 | 17,8 | 2,18 | 26,5 | 7,47 |
| Science Enrolment Ratio (%), 2005 | 4,7 | 0,91 | 5,5 | 1,82 | 4,2 | 0,8 |
| Researchers in R&D, 2004 | 21257 | 6,77 | 14904 | 5,94 | 85211 | 8,54 |

Ending of the table 2

| 1 | 2 | 3 | 4 | 5 | 6 | 7 |
|---|--------|------|--------|------|--------|------|
| Researchers in R&D / Mil, People, 2004 | 976 | 4,9 | 1472 | 5,94 | 1749,1 | 6,56 |
| Total Expenditure for R&D as % of GDP, 2004 | 0,4 | 3,72 | 0,88 | 6,38 | 1,16 | 7,02 |
| Manuf. Trade as % of GDP, 2005 | 53,5 | 7,23 | 94,2 | 9,23 | 53,6 | 7,38 |
| Technical Journal Articles, 2003 | 988 | 6,91 | 2503 | 7,55 | 2089 | 7,41 |
| Technical Journal Articles / Mil. People, 2003 | 45,5 | 5,9 | 247,8 | 7,77 | 43,7 | 5,83 |
| Availability of Venture Capital (1-7), 2006 | 3 | 3,61 | 3,8 | 6,81 | 3,2 | 4,71 |
| High-Tech Exports as % of Manuf. Exports, 2005 | 3,4 | 3,72 | 24,5 | 8,53 | 3,7 | 3,88 |
| Education (by the UNCD data [12]) | | | | | | |
| Adult Literacy Rate (% age 15 and above), 2004 | 97,3 | 6,47 | 99,36 | 7,55 | 99,4 | 7,63 |
| Public Spending on Education as % of GDP, 2005 | 3,6 | 2,66 | 5,9 | 7,42 | 6,4 | 8,15 |
| Prof. and Tech. Workers as % of Labor Force, 2004 | 17,44 | 3,7 | 27,65 | 7,65 | 25,34 | 6,67 |
| Information and communication technologies (by the ITU data [13]) | | | | | | |
| Total Telephones per 1,000 People, 2005 | 820,3 | 6 | 1256,7 | 7,5 | 621,6 | 5,21 |
| Main Telephone Lines per 1000 People, 2005 | 203 | 5,47 | 332,7 | 7,55 | 255,9 | 6,19 |
| Mobile Phones per 1,000 People, 2005 | 617,3 | 6,43 | 924 | 8,07 | 365,7 | 4,57 |
| Computers per 1,000 People, 2005 | 113 | 5,83 | 146 | 6,52 | 38,4 | 3,18 |
| International Internet Bandwidth (bits per person), 2005 | 622,94 | 7,06 | 991,37 | 7,5 | 17,16 | 3,38 |
| Internet Users per 1,000 People, 2005 | 207,5 | 6,43 | 297,4 | 7,21 | 96,9 | 4,57 |
| ICT Expenditure as % of GDP, 2005 | 3,6 | 1,73 | 5,84 | 4,67 | 8 | 8,13 |

Determining at the analysis of any object, especially scientific and technical potential of country, application of approach of analysis of dynamics comes forward. At table 3 the change of base indexes which determine efficiency of economy of knowledge on methodology of the World bank is presented, which influence on development and realization of scientific and technical potential for Romania, Hungary and Ukraine.

Table 3. Basic variables which defined knowledge economy performance

| Variable | Romania | | Hungary | | Ukraine | |
|--|---------------|-------|---------------|--------|---------------|-------|
| | most recent * | 1995 | most recent * | 1995 | most recent * | 1995 |
| Annual GDP Growth (%), * avg 2001-2005 | 5,7 | 2,1 | 4,2 | 1,9 | 7,7 | -12,5 |
| Human Development Index, *2004 | 0,8 | 0,77 | 0,87 | 0,81 | 0,77 | 0,74 |
| Tariff & Nontariff Barriers, *2007 | 74 | 94 | 76,6 | 56 | 72,2 | 50 |
| Regulatory Quality, *2005 | 0,17 | -0,59 | 1,11 | 0,45 | -0,26 | -0,63 |
| Rule of Law, *2005 | -0,29 | -0,34 | 0,7 | 0,62 | -0,6 | -0,73 |
| Royalty Payments and Receipts (US\$/pop.) *2005 | 10,2 | 0,5 | 188,4 | 9,9 | 9,4 | n/a |
| Technical Journal Articles / Mil, People, *2003 | 45,5 | 28,55 | 247,8 | 177,28 | 43,7 | 55,46 |
| Patents Granted by USPTO / Mil. People, *avg 2001-05 | 0,34 | 0,1 | 5,54 | 4,44 | 0,43 | 0,16 |
| Adult Literacy Rate (% age 15 and above), *2004 | 97,3 | 97,6 | 99,36 | 99,2 | 99,4 | 99,5 |
| Gross Secondary Enrollment Rate, *2005 | 85,1 | 77,9 | 96,5 | 97,8 | 88,7 | 92,61 |
| Gross Tertiary Enrollment Rate, *2005 | 40,2 | 18 | 59,6 | 23,6 | 69 | 41,7 |
| Total Telephones per 1,000 People, *2005 | 820,3 | 131,3 | 1256,7 | 234,5 | 621,6 | 161,6 |
| Computers per 1,000 People, *2005 | 113 | 13,2 | 146 | 38,7 | 38,4 | 8,3 |
| Internet Users per 1,000 People, *2005 | 207,5 | 0,7 | 297,4 | 6,8 | 96,9 | 0,4 |

The analysis of table 3 testifies to paradoxical scientific and technical and social development in Ukraine. From one side, Ukraine occupied and takes first seat among select countries after the index of formed of population and particle of population with higher education, and from other side by the level of human development Ukraine is the last. This feature testifies to existence of other factors which influence in a greater degree, knife factors of education and literacy of population on social development in a country.

Human Development Index (HDI) calculates as a weighted average of human development measuring indexes (a life interval measured by one index, educational level – by two indexes, GDP per capita – by one index):

$$HDI = \sum_{j=1}^i \alpha_j \cdot \frac{X_j - m_j}{M_j - m_j}, \quad (2)$$

where M_j , m_j is a maximum and minimum value of human development indexes; X_j : X_1 is a life interval (minimum value - 25 years, maximum - 85 years), X_2 is an educational level of adults (from 0 to 100 %), X_3 is an education density in primary, middle and high school (from 0 to 100 %), X_4 is the special indicator of welfare which calculates as a common logarithm of real GDP per capita (from 100 to 40 000 USD by PPP); α are weighting coefficients of indexes which are asserted thus that three measuring human development indexes had equal weight.

Among 18 competitive edges of Ukraine: quality of infrastructure on the ferrous road (31th place), national debt (17th), quality of primary education (49th), access to higher education (17th), quality of mathematical and essential education (44th), quality of the elucidative system (47th), practical worker of a second job and liberation (16th), attitude of the labour productivity toward of the earnings (26th), participation of women in labour activity (26th), control after international distribution (46th), capacity for the innovations (40th) [14, 15].

Among 92 lacks of economy of Ukraine: inflation (106th place), trades barriers (123th), tax pressure (123th), limitation on the capital (102th) flow, efficiency of antimonopoly policy (98th), quality of highways (116th), quality of aviation infrastructure (116th), professionalism

of leaders of higher link (102th), fluidity of brains (93th), rates of distribution of tuberculosis (86th) and HIV (104th), mean time of life (89th).

Structural changes

The indicator of the state of scientific and technical potential in Ukraine subjected to impact of the structural changes in an economy, which are traced, in particular, in the change of structure of GDP (table 4).

Table 4. Structure of gross domestic product in Ukraine at 1985-2007, % [16, 17]

| Economy branches | Years | | | | | | |
|-----------------------------|-------|------|------|-----------|-----------|-----------|---------------|
| | 1985 | 1990 | 1993 | 2003 [18] | 2004 [18] | 2005 [18] | 2007 [19, 20] |
| GDP, total | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| Including: | | | | | | | |
| Industry | 41,4 | 35,9 | 43,6 | 30,4 | 28,5 | 28,2 | 31,0 |
| Agriculture | 19,4 | 24,0 | 14,2 | 12,2 | 11,9 | 10,9 | 9,0 |
| Civil Engineering | 8,5 | 7,7 | 9,8 | 4,3 | 4,6 | 4,7 | 5,4 |
| Transport and communication | 6,3 | 6,1 | 8,8 | 14,7 | 13,7 | 13,9 | 14,6 |
| trade, raw material supply | 6,0 | 5,7 | 6,3 | 19,5 | 23,8 | 24,7 | 27,2 |
| others | 18,4 | 20,6 | 17,3 | 19,0 | 18,2 | 17,6 | 12,8 |

Share of industry for period 1985-2005 diminished from 41,4 to 28,2 % (at 2007 the particle of industry was 31 %, that is arrived at mainly by growth of prices index on industrial products and growth of cost of resources), agriculture - 19,4 to 10,9 %, building - from 8,5 to 4,7 %. Specific gravity of transport and connection was multiplied - from 6,3 to 13,9 %, and also, at what salutatory, trade, logistical support and semi's - from 6,0 to 24,7 %.

At the same time in the developed countries there is growth of particle of industry in structures GDP countries (table 5, 6).

Table 5. GDP's structures of the countries, %

| | Agriculture | | Industry | | Services | | | |
|---------------|-------------|------|----------|------|----------|------|------------|------|
| | | | | | GDP | | Employment | |
| | 1994 | 2004 | 1994 | 2004 | 1994 | 2004 | 1995 | 2005 |
| Great Britain | 1.7 | 1.0 | 30.6 | 24.3 | 67.7 | 74.7 | 70.7 | 76.5 |
| Germany | 1.2 | 1.1 | 32.9 | 29.1 | 65.9 | 69.8 | 60.5 | 67.6 |
| Italy | 3.3 | 2.5 | 30.1 | 27.3 | 66.6 | 70.2 | 59.2 | 64.6 |
| Norway | 3.0 | 1.5 | 32.9 | 39.2 | 64.1 | 59.2 | 71.4 | 75.8 |
| USA | 1.9 | 1.3 | 26.4 | 22.2 | 71.7 | 76.7 | 73.1 | 78.6 |
| France | 3.3 | 2.5 | 24.7 | 21.3 | 73.1 | 76.3 | 69.1 | 73.5 |
| Sweden | 2.7 | 1.8 | 28.7 | 27.7 | 68.7 | 70.5 | 71.0 | 76.0 |
| Japan | 2.1 | 1.6 | 33.9 | 29.0 | 64.0 | 69.4 | 60.8 | 67.6 |
| Hungary | 6.4 | 3.9 | 30.0 | 30.9 | 63.7 | 65.2 | 58.2 | 62.2 |
| Poland | 6.4 | 2.9 | 36.2 | 32.1 | 57.4 | 65.0 | 45.4 | 53.4 |
| Czech R. | 4.9 | 3.3 | 38.8 | 37.9 | 56.1 | 58.8 | 51.1 | 56.4 |
| Russia | 6.2 | 5.8 | 42.5 | 35.2 | 53.5 | 59.0 | 49.7 | 60.6 |

Sources: OECD in figures. Statistics of the member countries 2006-2007 Ed. Paris, 2007. – P. 16, 17, 22, 23; Russian statistics yearbook. Moscow, 1997. – P. 115, 312; National assets of Russia in 1997-2004. M., 2006. – P. 74

The share of hi-tech modes in domestic good production is insignificant, while low tech modes are prevailing. While the developed countries invest the considerable sums on hi-tech production, there are opposite tendencies in Ukraine: 1) growth of general production takes place due to industries of 3d and 4th technological modes; 2) production of food industry grows the greatest rates; 3) growth of low tech and raw materials industries overtake which is formed the country export. The developing countries characterized with the following average industry division investments in period of 1990 - 2007 by data of OECD: energy and power - 15 %, hi-tech production - 12 %, raw materials - 19 %, telecommunication - 16 %, financial services - 12 %, consumers goods and services - 9 %, other - 17 %.

Table 6. Dynamics of branch structure of the services, %

| Country | Specific particle of large of particular a branch groups at GDP % | | | | | | | | | |
|---------------|---|------|---|------|---|------|--|------|----------------|------|
| | Trade, feed, hotel business | | Transport, connection, ware-house economy | | Finances, insurance, real estate, business services | | Education, health protection, social service | | State services | |
| | 1994 | 2004 | 1994 | 2004 | 1994 | 2004 | 1994 | 2004 | 1994 | 2004 |
| Great Britain | 14.0 | 15.0 | 7.8 | 7.2 | 24.0 | 30.0 | 15.1 | 16.7 | 6.3 | 4.9 |
| Germany | 12.2 | 12.4 | 5.7 | 5.6 | 26.0 | 29.1 | 14.9 | 16.4 | 6.8 | 6.0 |
| Italy | 17.1 | 15.5 | 6.5 | 7.7 | 21.8 | 26.6 | 13.3 | 13.1 | 6.4 | 6.4 |
| Norway | 12.1 | 10.3 | 10.5 | 8.8 | 18.8 | 20.6 | 16.5 | 17.5 | 6.1 | 5.0 |
| USA | 17.7 | 15.4 | 6.7 | 6.1 | 27.0 | 32.4 | 11.4 | 15.8 | 8.0 | 7.5 |
| France | 13.3 | 13.1 | 6.7 | 6.3 | 27.9 | 31.4 | 14.3 | 17.3 | 8.4 | 7.6 |
| Sweden | 12.3 | 12.1 | 8.1 | 8.2 | 21.4 | 24.4 | 18.5 | 21.0 | 6.4 | 5.5 |
| Japan | 14.0 | 12.7 | 6.4 | 6.8 | 15.9 | 18.2 | 15.0 | 17.4 | 4.9 | 5.5 |
| Hungary | 20.1 | 20.7 | 6.4 | 7.7 | 11.0 | 16.4 | 12.3 | 13.1 | 7.1 | 7.1 |
| Poland | 14.1 | 14.5 | 10.4 | 15.9 | 15.9 | 16.3 | 10.1 | 11.1 | 5.0 | 6.0 |
| Czech R. | 13.3 | 12.6 | 8.8 | 8.1 | 17.7 | 20.7 | 14.5 | 14.5 | 7.5 | 9.4 |
| Russia | 18.4 | 22.0 | 9.9 | 8.7 | 5.8 | 12.0 | 7.4 | 6.2 | 6.7 | 10.4 |

Sources: OECD in figures. Statistics of the member countries 2006-2007 Ed. Paris, 2007. – P. 16, 17, 22, 23; Russian statistics yearbook. Moscow, 1997. – P. 115, 312; National assets of Russia in 1997-2004. M., 2006. – P. 74

Table 7. Share of industries of industry at GDP world countries [21, p. 333]

| Industries | Share of industries at GDP, % | | |
|----------------------|-------------------------------|---------------------------|--------------------|
| | Ukraine | Developed countries of EU | World on the whole |
| Machine building | 13,1 | 34,3 | 29,1 |
| Metallurgy | 28,2 | 6,9 | 6,9 |
| Chemical industry | 5,9 | 11,6 | 11,2 |
| Light industry | 1,6 | 6,5 | 7,8 |
| Food retail industry | 16,1 | 9,1 | 10,7 |
| Other industries | 35,1 | 31,6 | 34,3 |

From positions of world economy of change in the structure of GDP of Ukraine carry appropriate character definitely. It is correlation of sphere of production and sphere of consumption. But falling of specific gravity of industry almost in 1,5 times, building - almost twice, in 4 times growth sphere of consumption during 15 years are extraordinarily sharp changes not only from positions of economy, but also politicians, to psychology of population, science system, education and others like that. The particle of industry of Ukraine after the index of gross valueadded makes in recent years approximately 30-32 %, in that time as at the USA - 26,2 %, to Japan - 25, 4 %, to France - 24,4 % [22].

Under act of high-quality changes in the global technological systems the economic developed countries strengthen the influence on economic and social development of humanity. The of particular a branch structure of world industry which key positions occupy in is progressive: machine building (40 % all products), chemical industry (over 15 %), food retail industry (14 %), light industry (9 %), metallurgy (7 %). Electronic and electrical engineering industry develops by rapid enough rates.

Technological component

The presence of advanced technologies provides stable growth of industry and support of level of competitiveness of products in an of long duration prospect. However able modern technologies are to develop country with high scientific and technical potential and developed infrastructure [23, p. 144].

The purchase of the newest technologies requires the considerable capital investments and technicians-and-engineers with the high degree of the labour productivity. In Ukraine the labour productivity for industries of radio electronics and instrument-making at 2006 was in 20 times below than world average the noted industries of industry.

The decline of hi-tech industries of industry during 90th, which were characterized in a world on the whole by most rates of development, resulted in considerable lag of domestic level of technologies from technological development of other countries (table 8).

Table 8. Technology Level rating of the countries in 2004 by UNCTAD [24]

| Country | Rating | Estima tion | Country | Rating | Estima tion | Country | Rating | Estima tion |
|-------------|--------|----------------|-------------|--------|----------------|--------------|--------|----------------|
| USA | 1. | 6.24 | AEU | 25 | 4.71 | Columbia | 68 | 3.6 |
| Taiwan | 2. | 6.04 | Slovenia | 26 | 4.71 | Salvador | 69 | 3.6 |
| Finland | 3. | 5.92 | Malaysia | 27 | 4.67 | Venezuela | 70 | 3.6 |
| Sweden | 4. | 5.8 | Slovak R. | 28 | 4.67 | Peru | 71 | 3.45 |
| Japan | 5. | 5.68 | Hungary | 29 | 4.66 | Kenya | 72 | 3.31 |
| Denmark | 6. | 5.34 | France | 30 | 4.65 | Indonesia | 73 | 3.31 |
| Switzerland | 7. | 5.25 | Belgium | 31 | 4.59 | Morocco | 74 | 3.3 |
| Israel | 8. | 5.25 | Chili | 32 | 4.55 | Serbia&Mont. | 75 | 3.3 |
| S. Korea | 9. | 5.18 | Lithuania | 33 | 4.51 | Macedonia | 76 | 3.26 |
| Norway | 10. | 5.17 | Hong Kong | 34 | 4.49 | Uganda | 77 | 3.22 |
| Germany | 12. | 5.08 | Latvia | 35 | 4.46 | Ghana | 78 | 3.21 |
| Canada | 13. | 5.05 | Ireland | 36 | 4.43 | Georgia | 80 | 3.18 |
| Island | 14. | 5.05 | Greece | 37 | 4.42 | Sri-Lanka | 81 | 3.17 |
| Eesti | 15. | 5.01 | Cyprus | 38 | 4.36 | Bosnia&Herz. | 82 | 3.15 |
| Netherlands | 16. | 4.98 | SAR | 39 | 4.33 | Ukraine | 83 | 3.15 |
| Australia | 17. | 4.93 | Luxembourg | 40 | 4.28 | Tanzania | 84 | 3.12 |
| UK | 18. | 4.92 | Bulgaria | 59 | 3.82 | Pakistan | 87 | 3.02 |
| Czech R. | 19. | 4.88 | Philippines | 61 | 3.72 | Nigeria | 89 | 2.99 |
| Spain | 20. | 4.86 | China | 62 | 3.72 | Vietnam | 92 | 2.92 |
| Malta | 21. | 4.85 | India | 63 | 3.72 | Bolivia | 95 | 2.81 |
| Austria | 22. | 4.85 | Egypt | 65 | 3.68 | Malawi | 97 | 2.74 |
| Portugal | 23. | 4.78 | Namibia | 66 | 3.66 | Algeria | 98 | 2.67 |
| N.Zeland | 24. | 4.76 | Russia | 67 | 3.65 | Madagascar | 99 | 2.64 |

In such industries as radio- and microelectronics of lag is so considerable, that introduction of the imported leading technologies will not provide achievement of world average level of

competitiveness of products through the protracted term of introduction (at least 3 years), shortage of skilled shots, absence of domestic demand on a component electronic base.

Subsequent development of hi-tech industries is possible due to the association of local technological cells in Ukraine, which confess so far in a world conducting, however not finding proper material and technical and production base in Ukraine, in the conditions of undeveloped internal market on high technologies lose the efficiency and more frequent in all become the object of sale. The association of local technical and technological innovations in Ukraine will be instrumental in creation of macrotechnologies. In particular, the countries of G7 own 46 from 50 macrotechnologies, from them - 22 technologies are controlled by the USA, 10 - Germany, 7 - Japan, for 3-5 - Great Britain and France, for to one is on Sweden, Norway, Italy, Switzerland [25, p. 8-9].

Personnel potential and science intensiveness

The investment flow level in science and scientific and technical works in Ukraine do not allow not only creating new knowledge but also saving inherited scientific and technical potential from soviet times. Meantime, the R&D expenditures of high-tech multinational companies amount to 10 % of revenue. Thus, the domestic enterprise competition on the world markets of high technologies is difficult.

In particular, expenditures on R&D by telecommunications companies in the world range from 0,1 to 4 % of revenue. The comparative analysis of some telecommunications companies of world is resulted at table 9 testifies to the considerable differences in financing of R&D to the amount of R&D personnel. Volumes of charges on R&D, which are on one specialist busy in this sphere, is seen ineffective for the monopolist company at industry of information and communication technologies. By investigation of long duration not small rates of investment of R&D per one worker on JSC „Ukrtelekom” there is bringing in of strangers of enterprises structures to development of network of the third generation of cellular in Ukraine through the shortage of specialists able to execute works of such complication in the state of enterprise which counts 127 thousands of people.

Considerable growth rates are observed in domestic industry of information and communication technologies in comparing with other regions and arrived at due to introduction and use of technologies of: Asiatic production (for services with the low requirements of reliability and quality) – services of mobile communication of JSC „Ukrtelekom” on the base of technologies of Huawei; European producers (for services high-reliability and unfaulteness) of cross equipment and fiber equipment of Reichle&De-Massari for the mains of connection of JSC „Ukrtelekom”.

Table 9. Financial performance indicators, expenditures on R&D and quantity of R&D personnel in 2006

| Company | Revenue, mln. USD | Expenditures on R&D, mln. USD | R&D personnel | Expenditures on R&D per R&D personnel amount, thsd. USD |
|-------------------------|-------------------|-------------------------------|-------------------|---|
| France Telecom | 60,316 | 2413 | 3780 ¹ | 638,36 |
| British Telecom Group | 38,638 | 390 | 1695 ¹ | 230,09 |
| Deutsche Telekom | 79,751 | 1595,0 4 | 4832 ⁴ | 330,01 |
| Ukrtelecom ² | 1,541 | 2,1 | 2124 | 0,989 |
| Rostelecom ³ | 2,318 | 3,47 | 1531 | 2,266 |

¹ London Stock Exchange's Regulatory News Service <http://miranda.hemscott.com/>

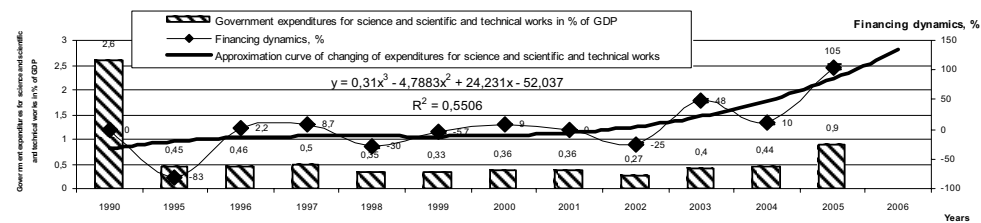
² Україна телекомунікаційна. Річний звіт БАТ «Укртелеком» 2006 [Electronic Resource] / Укртелеком, 2007. – Read 24 April 2007.

³ Алло. Годовой отчет ОАО «Ростелеком» 2006 [Electronic Resource] / Ростелеком, 2007. – Read 25 April 2007.

⁴ Rathe, K. Deutsche Telekom in Transition [Electronic Resource] / TelecomVisions©, 2001. – Read 13 Nov 2007.

The shortage of highly skilled shots in domestic industry is investigation of the low financing of science and scientific and technical works at state level (fig. 2).

Figure 2. Government expenditures for science and scientific and technical works in % of GDP in Ukraine [26]



At development and realization of measures in relation to the revival of scientific and technical development of Ukraine the account of critical standards of science intensiveness comes forward important at the level of the state (choice of partners of countries recognition their level of science intensiveness) and industries (table 10, 11 [27, p. 180]).

Table 10. Indexes of level of scientific and technical development of some countries

| Country | Share of the country, % | | | |
|------------------|-------------------------|-------------|----------|-------------|
| Year | 1998 | | 2005 | |
| Comparing method | In total | With leader | In total | With leader |
| Ukraine | 1.5 | 3.6 | 3.0 | 7.5 |
| Poland | 3.0 | 7.2 | 3.0 | 7.5 |
| Hungary | 4.0 | 9.5 | 3.5 | 8.7 |
| Russia | 7.5 | 17.8 | 9.5 | 23.7 |
| UK | 20.5 | 48.8 | 21.0 | 52.5 |
| France [28] | 21.5 | 51.2 | 20.0 | 50.0 |
| Germany | 42.0 | 100.0 | 40.0 | 100.0 |

Table 11. World average science intensiveness of separate branches of industry

| Branches of industry | Science intensiveness (R&D expenditures in revenue), % |
|---|--|
| Energy sources | 0.8-1.0 |
| Food and light | 1-1.2 |
| Agriculture | 1-1.2 |
| Machine building | 3.3 |
| Chemical | 3.5 |
| Electronics and telecommunication | 6.0 |
| Aeronautics, cosmos and aircraft building | 5-7 |
| Pharmacy | 10.0 |

Conclusions

1. The estimation of scientific and technical potential must include at itself all complex of infrastructures of hi-tech production. Scientific and technical potential of country depends far of external factors such as GDP per capita, level of formation of population, unemployment rate and others like that.
2. Conception of economy of knowledge is an attempt complex to estimate scientific and technical potential of countries recognition row of external, on the face of it mediated factors.
In some periods of development or forming of scientific and technical potential the factor of infrastructure can take form determining, that is observed in the countries of South-east Asia, where considerable development of information and communication infrastructure stimulated realization of scientific and technical potential (information and communication maintains) [29, p. 30].
3. The disproportion of development scientific and technical and socio-economic spheres in Ukraine in comparison with the neighbor-countries geographically and partners of countries for the former integration unit – Council for Mutual Economic Aid – Hungary and Romania is traced during the last 12 years. This tendency is explained by local of particular a branch tailings of scientific and technical potential of Soviet Union considerable part of which was reached to Ukraine in the inheritance, and which was successfully lost in many ways.
4. The displacement of economy development character toward domestic (production of domestic equipment from the imported stuffs after the SKD and MKD production charts) and consumer take place in Ukraine.
5. We see, that the relation of results must become the objective estimation of realization of scientific and technical potential (by his efficiency) got from the use of this potential (socio-economic effect) to the cost of constituents of scientific and technical potential (expense on the scientific and technical personnel training during a few generations (50-80 years), expense on development of informative infrastructure, market value of highly skilled specialists which drove out for a border, and others like that).

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COMPARISON OF PRICE REACTION CHOSEN INDIRECT CRUDE OIL INVESTMENT TO TREND IN CRUDE OIL PRICES

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Abstract

Investments in crude oil recently belong among the most profitable ones. Among these investments I include direct crude oil futures investments and modern structured indirect investments (in this case warrant) with crude oil being the underlying asset, crude oil companies funds investments, crude oil fund investments or crude oil companies stock investments. However development of prices of particular indirect investments differ not only comparing to each other but also comparing to direct investments in the commodity. The goal of my entry is to identify and compare different warrant price development reflectance to American crude oil and American crude oil companies' stock using the determination of so called psychological barrier regarding three time periods.

Key words: *Crude oil, warrant, stocks, psychological barrier, time periods.*

Introduction

My work deals with financial markets sphere. Permanent development of this part of economy in last decades produces new financial products. Warrants¹ are among the most modern ones. Comparing to shares warrant is a cheaper investment instrument and it precisely traces and multiplies the price effect of underlying asset development (crude oil in this case) which it projects in its value. Warrants therefore fulfill my requirements of price, maturity and other investment conditions. The goal of my work is to compare different warrant strategies at the crude oil market and to point out its advantages comparing to investment to shares of chosen US companies dealing with crude oil regarding three time periods – short term, medium term and long term. I will show this in the first chapter of my work. In my research markedly lower crude oil price development reflectance showed concerning tracked shares and the so called psychological barrier occurred. This means that the shares price, in contrast to warrants, did not react at all to crude oil price development in certain periods. I will show this in the second chapter of my work.

Used research methodology

Financial derivatives are financial instruments that are linked to a specific financial instrument or indicator or commodity, and which provide for market financial risk in a form that can be traded or otherwise offset in the market. Financial derivatives are used for a number of purposes including risk management, hedging, and speculation. Unlike with debt instruments, no principal

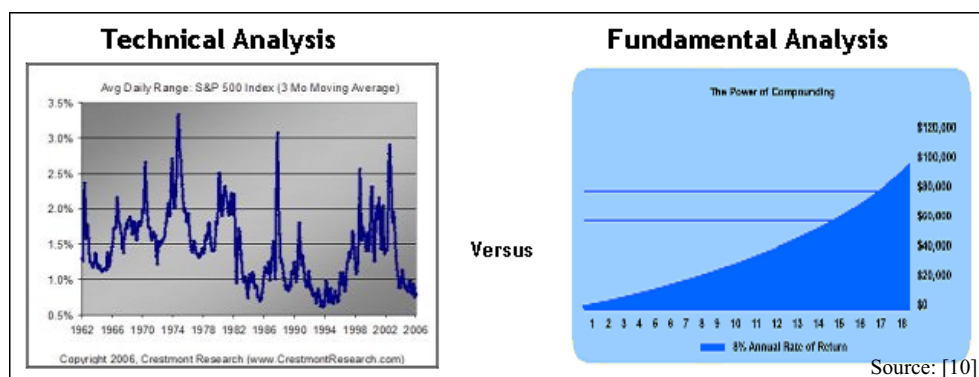
¹ A warrant, like an option, gives the holder the right but not the obligation to buy an underlying security at a certain price, quantity and future time. There are two different types of warrants: a call warrant and a put warrant. A call warrant represents a specific number of shares that can be purchased from the issuer at a specific price, on or before a certain date. A put warrant represents a certain amount of equity that can be sold back to the issuer at a specified price, on or before a stated date.

amount is advanced to be repaid, and no investment income accrues. The value of the financial derivative derives from the price of the underlying items. [8]

When day trading, a trader makes the decision about what to trade, when to trade, and how to trade, using either fundamental or technical analysis. Both forms of analysis involve looking at the available information and making a decision about the future price of the market being traded, but the information that is used is completely different. Is it possible to use both fundamental and technical analysis together, but it is more common for a trader to choose one or the other. Fundamental traders use information about the global and national economies, and the financial state of the companies involved, as well as non financial information such as current political and weather information. Fundamental traders believe that the markets will react to events in certain ways and that they can predict future market prices based on these events. For example, if a company receives regulatory approval for a new product, a fundamental trader might expect the company's stock price to rise. Conversely, if a company has a financial scandal, a fundamental trader might expect its stock price to fall. Fundamental traders need access to all of the available information as soon as it is available, and are therefore often institutional traders with large support teams, rather than individuals. Fundamental analysis has probably been in use since there were markets to trade, and has traditionally been done manually, but as computing power increases it has become possible for some fundamental information to be processed automatically. Technical traders use trading information (such as previous prices and trading volume) along with mathematical indicators to make their trading decisions. This information is usually displayed on a graphical chart and is updated in real time throughout the trading day. Technical traders believe that all of the information about a market is already included in the price movement, so they do not need any other fundamental information (such as earnings reports). There are many different types of charts and many different mathematical indicators. Some indicators are better suited to short term trading, and others are better suited for longer term trend following trading. Individual traders are usually technical traders. Technical analysis appears to have been used at least 200 years ago in Japan. Modern technical analysis is usually performed by the trader interpreting their charts, but can just as easily be automated because it is mathematical. Some traders prefer automatic analysis because it removes the emotional component from their trading, and allows them to take trades based purely on the trading signals. [9]

Thereunder are made some comparisons of these strategies that people employ when playing the stock market. On the left hand column are images that to me, appear to closely reflect technical analysis; while the right hand column invokes images that reference fundamental analysis. Of course, these are just my casual notions about these two divergent investing methodologies. These differences aren't meant to be mutually exclusive nor comprehensive. [Modified 10]

Figure no. 1. Stock Market Volatility and The Power of Compounding

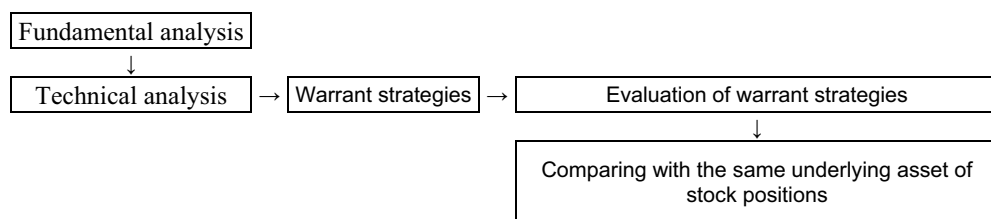


A derivative security that gives the holder the right to purchase securities (usually equity) from the issuer at a specific price within a certain time frame. Warrants are often included in a new debt issue as a "sweetener" to entice investors.

The main difference between warrants and call options is that warrants are issued and guaranteed by the company, whereas options are exchange instruments and are not issued by the company. Also, the lifetime of a warrant is often measured in years, while the lifetime of a typical option is measured in months. [11]

There are also call and put warrant. Theirs fundamental is for study in many literatures, so I won't be describing them in this paper.

Figure no. 2. Used investment diagram



Given the flexibility of warrants and the fast-paced nature of the markets, it is important to understand different warrant investment strategies in order to achieve the desired risk/reward profile. The figure number 2. generally describes my investment strategy. Every important methodology will be described in the following text.

The discussion of each strategy, I did in literature link [1, 2], includes the investment objectives, how is the strategy constructed, relevant examples, and benefits and risks. In this paper I do not deal this problem again, because of keeping this fundamental.

1. Business positions valuation

I created three investments strategies. The first of them is the long call strategy which contains two warrants (DZ3Z3H² and DZ3Z3F) with approximately two years maturity. I invested CZK 20,000 to these warrants while the sum was equally shared between both warrants. I still hold these warrants in my portfolio. The second investment strategy also contains two call warrants (DZ3Z3D and ABN069) with six months maturity. I invested CZK 20,000 to these warrants while the sum was again equally shared between both warrants. Regarding occurring conditions I sold these warrants and therefore I do not hold them anymore. The third strategy is the long put strategy which contains two put warrants (DZ1799 a DZ18AA) where the first one had a one month maturity (from the purchase date) and the second one had a six months maturity. I used the money from the cancelled 2nd investment strategy which means CZK 20,000 for the 3rd strategy investment. Again the sum was equally shared between both warrants. Therefore the total amount I invested was CZK 40,000.

² ISIN – International Securities Identification Number, using worldwide. Though in German speaking countries we can meet with a WKN (Wertpapierkennnummer) - six digits or capital letters (excluding I and O), no check digit. In the US are fully used "tickers" – mostly it is abbreviation name of a company that emitted security. WKNs may be obsolete in future, and be replaced by ISINs. ISINs are slowly being introduced worldwide. At present, many countries have adopted ISINs as a secondary measure of identifying securities, but as of yet only some of those countries have moved to using ISINs as their primary means of identifying securities.

Short term and long term time period

I chose the short term and long term period for the period from 03/12/2007 to 04/27/2007. The sheet no. 1 shows that the largest drop on the account was caused by the 1st strategy warrants (DZ3Z3H and DZ2Z2F) during the first stage. This drop was not yet very important as these warrants had two years maturity which made the possible situation change very probable. 3rd strategy warrants (DZ1799 and DZ18AA) showed minor profit. Although they got to the limit of minimal acceptable profit level they were sold thanks to the circumstances at the crude oil market. The highest profit was brought by the 2nd investment strategy containing call warrants DZ3Z3D and ABN069.

Sheet no. 1. Business positions valuation

| (in EUR) | 1 st investment strategy | | 2 nd investment strategy | | 3 rd investment strategy | |
|-----------------------------|-------------------------------------|--------------|-------------------------------------|---------------|-------------------------------------|---------------|
| | DZ3Z3H* | DZ3Z3F* | DZ3Z3D | ABN069 | DZ1799 | DZ18AA |
| Warrant purchase price | 1.40 | 1.08 | 1.17 | 1.21 | 0.98 | 1.02 |
| Warrant sale price | 1.67 | 1.31 | 1.68 | 1.70 | 1.36 | 1.31 |
| Change in pts | 0.27 | 0.23 | 0.51 | 0.49 | 0.38 | 0.29 |
| Change in pct | 16.17% | 17.56% | 30.36% | 28.82% | 27.94% | 22.14% |
| Purchased pieces | 233 | 271 | 307 | 297 | 364 | 349 |
| Purchase volume | 326.20 | 292.68 | 359.58 | 359.58 | 356.38 | 356.38 |
| Purchase fee | 28.83 | 28.49 | 29.17 | 29.17 | 29.14 | 29.14 |
| Number of sold pieces | 233 | 271 | 307 | 297 | 364 | 349 |
| Sale volume | 389.11 | 355.01 | 516.32 | 505.20 | 494.57 | 457.70 |
| Sale fee | 29.47 | 29.12 | 30.77 | 30.65 | 30.54 | 30.17 |
| Absolute profit/loss | 4.61 | 4.72 | 96.81 | 85.80 | 78.51 | 42.02 |
| <i>Relative profit/loss</i> | <i>1.41%</i> | <i>1.61%</i> | <i>26.92%</i> | <i>23.86%</i> | <i>22.03%</i> | <i>11.79%</i> |

Source: own processing + [6]

* Real sale was not made therefore I allege up-to-date values from the day of business positions evaluation (04/27/2007)

The total profit after summarizing all positions was EUR 312.47 on 04/27/2007. Regarding the 28.064 EUR/CZK exchange rate and hypothetical sales fee when selling DZ3Z3H and DZ3Z3F warrant, the total profit was CZK 8,717.7. The total valuation of all business positions was 21.79pct on 04/27/2007.

Long term time period

In this case I will evaluate only the 1st strategy warrants thus the long term time period warrants (DZ3Z3H and DZ3Z3F) from 03/12/2007 to 05/09/2008. The profit for DZ3Z3H warrant is EUR 719.55 when using up-to-date vales. The profit for DZ3Z3F warrant is EUR 871.13 when using up-to-date vales. Therefore the total profit at the moment of evaluation of business positions is EUR 1,893.80 which means CZK 48,147.7 regarding the 24.953 EUR/CZK exchange rate or 120.37pct.

Sheet no. 2. Business positions valuation

| (in EUR) | 1 st investment strategy | | 2 nd investment strategy | | 3 rd investment strategy | |
|-----------------------------|-------------------------------------|---------------|-------------------------------------|--------------|-------------------------------------|--------------|
| | DZ3Z3H* | DZ3Z3F* | DZ3Z3D | ABN069 | DZ1799 | DZ18AA |
| Warrant purchase price | 1.40 | 1.08 | 1.17 | 1.21 | 0.98 | 1.02 |
| Warrant sale price | 4.77 | 4.54 | 1.68 | 1.70 | 1.36 | 1.31 |
| Change in pts | 3.37 | 3.46 | 0.51 | 0.49 | 0.38 | 0.29 |
| Change in pct | 70.65 % | 76.21 % | 30.36% | 28.82% | 27.94% | 22.14% |
| Purchased pieces | 233 | 271 | 307 | 297 | 364 | 349 |
| Purchase volume | 326.20 | 292.68 | 359.58 | 359.58 | 356.38 | 356.38 |
| Purchase fee | 28.83 | 28.49 | 29.17 | 29.17 | 29.14 | 29.14 |
| Number of sold pieces | 233 | 271 | 307 | 297 | 364 | 349 |
| Sale volume | 1,111.41 | 1,230.34 | 516.32 | 505.20 | 494.57 | 457.70 |
| Sale fee | 36.84 | 38.05 | 30.77 | 30.65 | 30.54 | 30.17 |
| Absolute profit/loss | 719.55 | 871.13 | 96.81 | 85.80 | 78.51 | 42.02 |
| <i>Relative profit/loss</i> | 220.58 % | 297.64 | 26.92% | 23.86% | 22.03% | 11.79% |

Source: own processing + [6]

* Real sale was not made therefore I allege up-to-date values from the day of business positions evaluation (05/09/2008)

2. Warrants v. shares of US companies dealing with crude oil

To show the advantages of warrants I made a hypothetical comparison of virtual purchase of shares of three US companies dealing with crude oil (because I trade with American West Texas Intermediate light sweet crude oil in case of warrants) with the very same initial investment as when trading warrants which means CZK 40,000 in each company's share.

Due to threshold financial resources I decided for virtual purchases. Current month volume of business chosen US companies dealing with crude oil is approximately:

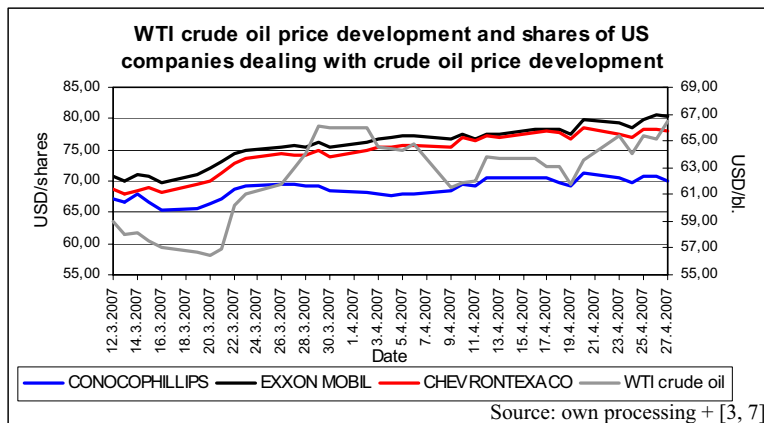
- CONOCOPHILLIPS 15 000 000 pcs.
- EXXON MOBIL 27 000 000 pcs.
- CHEVRONTEXACO 12 000 000 pcs.

Consequently in case that a given businesses would be realized in practice, they would have imponderable influence to development of three US companies prices. Therefore it is possible these valuables use for calculation of revenues these virtual businesses.

Development from 03/12/2007 to 04/27/2007

As the Figure no. 3. and text mentioned higher show I work with CONOCOPHILLIPS, EXXON MOBIL and CHEVRONTEXACO shares.

Figure no. 3. WTI crude oil price development and shares of US companies dealing with crude oil price development (03/12/2007-04/27/2007)



As shown at the first tracked period (03/12/2007-04/27/2007) the lowest profit came from investments into CONOCOPHILLIPS shares. On the other hand the highest profit came from CHEVRONTEXACO shares. Unlike when investing into warrants an exchange rate loss of USD 86 (CZK 1,770) occurred when investing into US shares in tracked period. This exchange rate loss produced loss to investments into CONOCOPHILLIPS shares while both EXXON MOBIL and CHEVRONTEXACO shares stayed with profit.

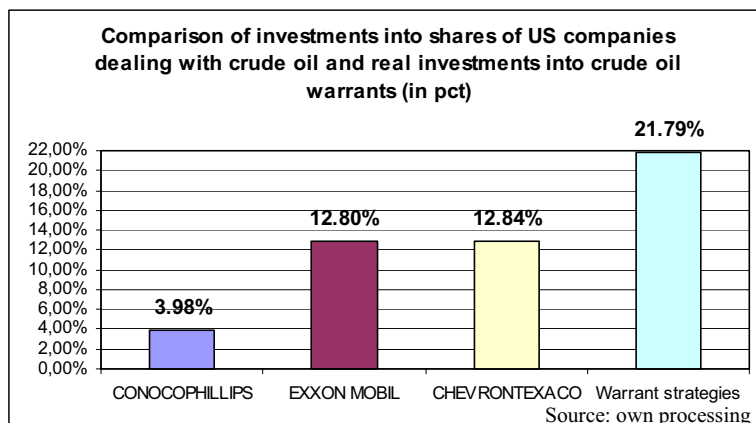
Sheet no. 3. Profit sheet of tracked US companies dealing with crude oil

| Company | No. of shares | Purchase (USD/share) | Sale (USD/share) | Profit (in USD) | Profit (in CZK) | Relative profit |
|----------------|---------------|----------------------|------------------|-----------------|-----------------|-----------------|
| CONOCOPHILLIPS | 28 | 67.24 | 70.04 | 77 | 1,592 | 3.98% |
| EXXON MOBIL | 26 | 70.87 | 80.36 | 249 | 5,119 | 12.80% |
| CHEVRONTEXACO | 27 | 68.83 | 78.08 | 250 | 5,138 | 12.84% |

Source: own processing + [3, 5]

Final comparison of results of both possibilities is shown in Figure no.4. Warrant strategies showed to be much more profitable comparing to alternative investment (shares of US companies dealing with crude oil) in this time period. While warrant reflected the immediate crude oil price development shares reacted with delay in some periods. The most remarkable period was from 02/26/2007 to 04/09/2007.

Figure no. 4 Comparison of investments into shares of US companies dealing with crude oil and real investments into crude oil warrants (in pct).

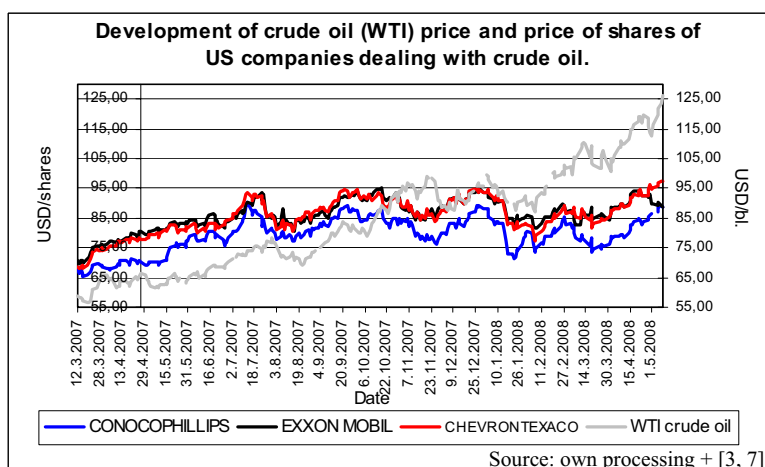


So called psychological barrier occurred at shares prices in this case and shares value was not rising above this barrier though the crude oil price was rising. I will not analyze this situation since it is not a part of this entry due to its size, exactitude and topic. Therefore I open an area for a new work that would fully explain this extreme of emergence of psychological barrier at particular financial assets markets.

Development from 03/12/2007 to 05/09/2008

The following figure shows the crude oil price and price of shares of US companies dealing with crude oil developed after the date of closing and evaluating business positions.

Figure no. 5. Development of crude oil (WTI) price and price of shares of US companies dealing with crude oil. (03/12/2007-05/09/2008)



The difference between shares and warrants (crude oil) value development is much bigger in long term time period than in short term and medium term time period. US companies dealing with crude oil saw the crude oil price development as a quite doubtful element and therefore the price of their shares was based rather on emotive seeing of crude oil price than on reasonable consideration. For example in periods of 10/22/2007-12/9/2007 and 02/27/2008-03/30/2008 the so called psychological barrier activity showed very markedly, when while the crude oil price was rising the value of shares of US companies dealing with crude oil did not react to this development and on the contrary it was falling. In this case the crude oil price was above USD 90 or USD 105 per bl.

The simulation of virtual alternative investments is shown in Sheet no. 4.

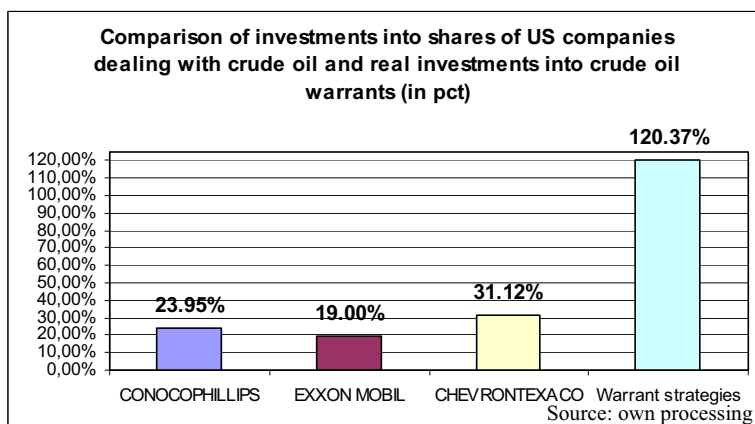
Sheet no. 4. Profit from holding shares of US companies dealing with crude oil.

| Company | No. of shares | Purchase (USD/share) | Sale (USD/share) | Profit (in USD) | Profit (in CZK) | Relative profit |
|----------------|---------------|----------------------|------------------|-----------------|-----------------|-----------------|
| CONOCOPHILLIPS | 28 | 67.24 | 79.34 | 335 | 5,642 | 14.11% |
| EXXON MOBIL | 26 | 70.87 | 86.41 | 408 | 6,875 | 17.19% |
| CHEVRONTEXACO | 27 | 68.83 | 84.42 | 421 | 7,102 | 17.75% |

Source: own processing + [3, 5]

The exchange rate on the day of purchase (03/12/2007) was 21.513 USD/CZK and on the day of sale (05/09/2008) it was 16.134 USD/CZK. Therefore the exchange rate loss was much intensified, USD 619.896 (CZK 10,001.4) to be specific. This lead to loss when trading with shares of two tracked companies (CONOCOPHILLIPS and EXXON MOBIL). The profit of CHEVRONTEXACO shares was negligible. Warrants are, as also my work shows, designed for rather long term investment

Figure no. 6. Comparison of investments to shares of US companies dealing with crude oil and real investment in crude oil warrants (in pct).



Warrants reaction to crude oil price development were immediate which allowed to use different strategies and their appropriate application on emerging market situations lead to higher valuation of financial resources than when investing in shares. This premise was basically proved already in short term and medium term investment period. My work also

showed the unpredictability of dependence of assets price on the underlying asset development in the period of psychological barrier activity.

Conclusion

Advantages of warrants that result from their principles showed in all three regarded time periods (short term, medium term, long term) when preparing this work. Warrant strategies showed to be more profitable than investments in shares of US companies dealing with crude oil. While warrants reflected the crude oil price development immediately, shares reacted with delay or did not react at all or even reacted contrariwise. The immediate reaction of warrants which allowed to use different strategies and their appropriate application on emerging market situations lead to higher valuation of financial resources than when investing in shares.

Therefore my investment ended up with profit. The total valuation of warrant portfolio in short term and medium term time period was 21.79 pct on 04/27/2007. The maximum rate of profit, that was achieved by CHEVRONTEXACO, the most profitable US company dealing with crude oil, was 12.84 pct. Therefore warrants were nearly twice as profitable.

The total valuation of warrant portfolio in long term time period was 120.37 pct on 05/09/2008. The maximum rate of profit, that was achieved by CHEVRONTEXACO, the most profitable US company dealing with crude oil, was only 17.75 pct. Therefore warrants were nearly seven times as profitable. All the goals of my work were realized by this and the fundamental of my work was fulfilled.

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THE AWARENESS OF HAVING LIFE INSURANCE POLICY: AN EXPLORATORY STUDY AMONG LAGOS STATE UNIVERSITY STUDENTS IN OJO, LAGOS, NIGERIA

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Abstract

The paper examines the level of awareness of the importance Life Insurance policy among the Nigerian students using students of Lagos State University, Ojo-Lagos, in the South-West part Nigeria as our case study. This University was better known in the mid nineties for incessant Cult clashes right in the University campus, which resulted to unwanted deaths and maiming of innocent Students and Staff alike. We discovered that lost their lives , lost “entirely” because most of them were not insured. It was discovered through the simple descriptive survey adopted for this study, that most students are actually aware of the significance of Life Insurance policy especially the financial benefits one can derive in case of unexpected death of their parents but they are handicapped of possessing the policy because they cannot afford to buy one. The survey revealed that 71 percentage see taking Life Insurance necessary, 22 percentage see taking Life Insurance Compulsory, while 7 percentage did not see to why someone should considered taking Life Insurance. The study also found that taking care of Children’s future took approximately 67 percentage as main goal for the University Students taking Life Insurance in the future. Whereas 20 percentage perceived Wealth creation as the reason of taking Life Insurance policy after graduating from the University, while other reasons took 13 percentage.

Conclusively, it is suggested that the various stakeholders should make extra effort to let people know the importance of having Life Insurance at the early stage. University Students are most potential group because most of them are ready to buy this policy after they have graduated from the University.

Keywords: Insurance, Brokers, Policy, Compensation, Security Policyholders, Risk, Retirement

JEL Classification: D31, E21, G22, M52

INTRODUCTION

Life insurance has grown to encompass a wide variety of products. Most obviously and primarily, in its fundamental form, it is “**death insurance**”. It aims to compensate these policyholder’s dependents from financial losses following the demise of the policy hold. It compensates them for the loss of income; helps pay off the policy holder debts. Effectively, life insurance policies build up an off – balance sheet fund which the policy holder’s heirs tap into on policy holder demise. (Narasimham, 2000). Life insurance in the present age performs an important function for risk planning and channels a large flow of savings into investments through financial and capital markets. Life insurance is an important vehicle for encouraging and mobilizing individual savings calculate on an actuarial basis, to provide for a certain sum of money in an uncertain future. It is an instrument for contractual savings, based on an anticipated future value (i.e policy claim) from a sum of discounted present values (i.e the premiums). (Omar 2007)

RESEARCH METHODOLOGY

The research samples for this are students from Lagos State University, Ojo, there are about 6,000 students registered with this institution. The 500 questionnaires using random sampling technique were distributed in a period of 27 days in June - July 2007. A total of 458 results were received and compiled. This questionnaire is divided into two (2) sections, first was designed to gather the students' bio data and the second part was designed to gather the respondents' awareness on the importance of having life insurance policy.

LITERATURE REVIEW

Life insurance has become the most widely used means of family financial security planning. Apart from that, it can help ensure the financial security of family, pay the support of dependents and meet outstanding financial obligations when the policyholder dies. Furthermore individuals and families need to become aware of the benefits, issues and differences in various life insurance plans, (BCG, 2003).

Life insurance programs are an important part of an individual's financial plan. The traditional view of life insurance as a commodity – simply underwriting coverage, differentiated by price and little else evolving as communication, education, and benefit enhancements are added. Research and trends support the evolution of employer - based life insurance programmes from merely providing a benefit to beneficiaries at the point of claim to a programme that is an important, vent critical components to an individual's overall financial plan (metlife, 2001).

There are three main types of life insurance policies in actuarial literature (Back, 2000) including (a) whole life insurance – which provides a death benefit for lifetime (b) term life insurance - that provide a death benefit for a limited number of years and, (c) environment life insurance – which is a term life insurance with a saving component. In general terms, life insurance is a way of dealing with risk and a saving medium for consumers. It also plays important psychological and social roles. As (Hofstede, 1995) stated, the major function of life insurance is to protect against financial loss from loss of human life. Besides covering the risk of death, it also covers the risks of disability, critical illness, etc. Life insurance is therefore developed on the concept of human life value (Saying, 2003). Human life value approach focuses on the economic component of human life. Any event affecting an individual's earning capacity, retirement or unemployment (Black, 2000). The human life value concept provides the philosophical basis for thee life insurance, which is a product designed to protect the individual against two distinct risks Premature death and superannuating (Browne, 1993).

FINDINGS AND DISCUSSIONS

Opinion respondents of Genders towards awareness

Table 1 below shows that almost 86 percent of the respondents are agreed and aware that having life insurance would bring a lot of benefits such as providing financial security in the events of premature death or uncertain dire occurrence which merely providing a benefit to beneficiaries. It is proven that both male and female respondents are both aware with the roles of life insurance.

Opinion respondents of Ethnic groups towards awareness

Tables 2 provide details on ethnic groups from Hausas, Ibos, Yorubas, and other ethnic groups towards the importance of having life insurance. This is proved as over 100 percent of Yoruba ethnic group, approximately 30 percent of Ibo ethnic group and slightly more than 30 percent other ethnic group e.g. Ijaw, Irhobo, Itsekiri, Tiv e.t.c ethnic groups agreed and aware of the vital roles of insurance as part of their financial planning. Majority of these ethnic groups are believed and agreed with all the elements in the awareness section. This shows that most Nigerian students regardless from which ethnic groups they belong are very concerned and aware of the importance of having life insurance policy. There is no hassle for the insurance companies to convince these students as they are always aware of being a risk taker and the role of insurance policy in providing them some sort of financial protection.

Opinion respondents' age groups towards awareness

Table 3 shows most can be categorized as a potentially good risk planner when the study shows that most respondents from the age of 16-25 were well aware about the risk of having life insurance to protect them from unexpected events that can lead to financial insecurity. This is proven when majority of the respondents (i.e. 70 percent and 72 percent respectively totally agreed and agreed) and aware with the benefits of having life insurance. This indicates that the University students were actually aware on the risk of life uncertainty and perceived taking insurance as one way to address this risk.

Opinion respondents' information about life insurance towards awareness

The study as indicated in Table 4 found that there were 2 major sources for the respondents getting the information on the benefit of having life insurance whether there were from their parents, family members (44 percent) or from life insurance agents (more than 23 percent). Both sources contributed higher portion than other alternatives such as relatives, friends and mass media. This proved that those who stay close to the students really had a major impact towards creating awareness towards the importance of having life insurance. Personal touch indeed plays a vital role in creating and convincing potential insurance client.

Opinion respondents' reasons of taking life insurance towards awareness

The findings in Table 5 shows that there were six listed factors that lead to the main reasons for respondents in considering taking life insurance policy namely; death, accidents, illness, disability, disasters and retirement. The study concluded that majority of the respondents have chosen the three best factors that contribute into their main reason for taking the life insurance; accidents count 43 percent, illness count at more than 22 percent, and premature death count at about 16 percent. Although our life expectancy has slightly increased, our lifestyle has also become fast-paced, leading to more health complications and unnecessary illnesses. Consider the growing prevalence of lifestyle-related diseases such as heart trouble, diabetes and obesity.

Opinion respondents' classification of having life insurance towards awareness

Respondents gave a different reactions on the reasons that might encourage them taking life insurance policy. Majority of the respondents see taking life insurance necessary (almost 72 percent), about 22 percent see taking life insurance policy as compulsory, and only about 7

percent did not see to why someone should considered taking them. This is a very good indicator for this reflects that life insurance can be classified as a must in their everyday life and reflect that they are fully aware of its importance.

Opinion respondents' goals of having life insurance towards awareness

In Table 7, the study found that taking care of children's future (approximately 67 percent) as main goal for the University students taking life insurance in the future. Whereas 20 percent perceived Wealth creation as the reason of taking life insurance policy after graduating from the University, living to long, and dying too soon (approximately 7 percent and 6 percent respectively).

RECOMMENDATIONS AND CONCLUSION

This study though exploratory in nature, provides useful information to both policy makers in thee government and also the insurance accompanies.

The authorities at various level of tiers of government and stakeholders should encourage and intensifies campaign to help creating the awareness among the populace so that they could at least have some sort of extra financial protection to face the unexpected future events. Considering forms of risks Nigerians face daily, also our lifestyle has also become fast – paced, leading to more health complications and unnecessary illnesses.

Also, considering the growing prevalence of lifestyle – related diseases such as heart trouble, diabetes etc. The need to have insurance policy cannot be seen as option but a necessity due to the uncertainty of future events. The increasing costs of living and medical costs in Nigeria provide strong support to the need of having insurance policy as protection and security against unexpected financial obligation if anything happen to the policyholder.

Insurance Companies should take an effort to let people know the importance of having life insurance at the early stage. Giving talks and conduct awareness campaigns to students in the tertiary institutions might open up their mind so that they will be prepared in taking insurance policy in the future. They might not take them now but they will almost definitely take them in future, providing information on the importance of having life insurance should not be considered as business perspectives only but should also serve as responsibility to the society as a whole.

This group is the most potential group that insurance companies and brokers should target as their potential clients in the future. As most of them are ready to buy life insurance after they have graduated from the university, the insurance brokers need to take early step to promote and give this group an enlightenment towards the importance of having life insurance.

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APPENDICES

Table 1 Respondents Genders towards Awareness

| <i>Gender</i> | | | |
|---------------|-------------|---------------|--------------|
| | Male | Female | Total |
| Totally Agree | 21 {28%} | 54 {72%} | 75 {16.37%} |
| Agree | 92 {29.21%} | 223 {70.79%} | 315 {68.78%} |
| Less Agree | 14 {26.42%} | 39 {73.58%} | 53 {11.57%} |
| Not Agree | 6 {40%} | 9 {60%} | 15 {3.28%} |
| Total | 133 {100%} | 325 {100%} | 458 {100%} |

Table 2 Respondents Ethnic groups towards Awareness

| <i>Ethnic groups</i> | | | | | | |
|----------------------|--------------|-------------|---------------|---------------|-------------------------|--------------|
| | Hausa | Ibo | Yoruba | Others | Foreign Students | Total |
| Totally Agree | 4 {5.33%} | 9 {12%} | 49 {65.33%} | 13 {17.34%} | 0 {0%} | 75 {16.37%} |
| Agree | 18 {5.71%} | 56 {17.78%} | 203 {64.44%} | 37 {11.75%} | 1 {0.32%} | 315 {68.78%} |
| Less Agree | 2 {3.77%} | 6 {11.32%} | 37 {69.81%} | 8 {15.09%} | 0 {0%} | 53 {11.57%} |
| Not Agree | 2 {13.33%} | 4 {26.67%} | 9 {60%} | 0 {0%} | 0 {0%} | 15 {3.28%} |
| Total | 26 {100%} | 75 {100%} | 298 {100%} | 58 {100%} | 1 {100%} | 458 {100%} |

Table 3 Respondents Age towards Awareness

| <i>Ages</i> | | | | |
|---------------|--------------|--------------|---------------------|--------------|
| | 16-25 | 26-35 | 35 and above | Total |
| Totally Agree | 53 {70.67%} | 16 {21.33%} | 6 {8%} | 75 {16.37%} |
| Agree | 226 {71.75%} | 63 {20%} | 26 {8.25%} | 315 {68.78%} |
| Less Agree | 34 {64.15%} | 12 {22.64%} | 7 {13.21%} | 53 {11.57%} |
| Not Agree | 9 {60%} | 4 {26.67%} | 2 {13.33%} | 15 {3.28%} |
| Total | 322 {100%} | 96 {100%} | 41 {100%} | 458 {100%} |

Table 4 Respondents information about life insurance policy

| <i>Gender</i> | | | |
|----------------------------|-------------|---------------|--------------|
| | Male | Female | Total |
| Parents/Family Members | 14 {17.07%} | 68 {82.93%} | 82 {44.09%} |
| Relatives | 11 {5.5%} | 9 {4.5%} | 20 {10.75%} |
| Friends | 11 {64.71%} | 6 {35.29%} | 17 {9.14%} |
| Electronic and Print Media | 11 {45.83%} | 13 {54.17%} | 24 {12.90%} |
| Insurance Brokers | 18 {41.86%} | 25 {58.14%} | 43 {23.12%} |
| Total | 65 {100%} | 121 {100%} | 186 {100%} |

Table 5 Respondents reasons for taking life insurance policy

| <i>Gender</i> | | | |
|---------------|-------------|---------------|--------------|
| | Male | Female | Total |
| Accidents | 58 {29.29%} | 140 {70.71%} | 198 {43.23%} |
| Death | 19 {26.03%} | 54 {73.97%} | 73 {15.94%} |
| Illness | 29 {27.88%} | 75 {72.12%} | 104 {22.71%} |
| Disability | 8 {29.63%} | 19 {70.37%} | 27 {5.90%} |
| Disasters | 6 {35.29%} | 11 {64.71%} | 17 {3.71%} |
| Retirements | 13 {33.33%} | 26 {66.67%} | 39 {8.52%} |
| Total | 133 {100%} | 325 {100%} | 458 {100%} |

Table 6 Respondents classification of life insurance policy

| <i>Gender</i> | | | |
|---------------|-------------|---------------|--------------|
| | Male | Female | Total |
| Compulsory | 31 {31.31%} | 68 {68.69%} | 99 {21.62%} |
| Necessity | 87 {26.52%} | 24 {73.48%} | 328 {71.62%} |
| Unnecessary | 15 {48.39%} | 16 {51.61%} | 31 {6.77%} |
| Total | 133 {100%} | 325 {100%} | 458 {100%} |

Table 7 Respondents goals priorities towards awareness

| <i>Gender</i> | | | |
|-------------------|-------------|---------------|--------------|
| | Male | Female | Total |
| Wealth Creation | 19 {20.65%} | 73 {79.35%} | 92 {20.09%} |
| Children's Future | 92 {30.07%} | 214 {69.93%} | 306 {66.81%} |
| Living too long | 12 {36.36%} | 21 {63.64%} | 33 {7.21%} |
| Dying too soon | 10 {37.04%} | 17 {62.96%} | 27 {5.90%} |
| Total | 133 {100%} | 325 {100%} | 458 {100%} |

NON-OIL EXPORT DEVELOPMENT AND PROMOTION AS A VITAL STRATEGY FOR INCREASING FOREIGN EXCHANGE EARNING IN AN ECONOMY

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Abstract

Crude oil has been a prominent feature of Nigeria's external sector, and has remained basically the same since the late 60's. The continuous crude oil and gas exploration in the oil producing communities resulted in environmental degradation which now leads to youth and militia Restiveness in these communities. This has led to the upsurge in development and marketing of quality agricultural produce as a means of enhancing the foreign exchange earning capacity of Nigeria. The performance of Nigeria's non-oil exports has been impressive in recent years, in order to assess the situation the paper examines the contribution of the non-oil sector to the Nation's Gross Domestic Product using regression analysis.

The paper work recognizes that the non-oil sector can contribute more to the export earnings of Nigeria than the oil sector if properly managed and also sincere implementation of various policies aimed at improving the non-oil exports by the various tiers of Governments.

Keywords: *Environment, Export, Crude Oil, Degradation, Development, Promotion.*

JEL Classification: *H11, O13, O24, P33*

Introduction

Recent developments in the Nigerian economy had led to the recognition of the ultimate significance of development and marketing of quality agricultural produce as a means of enhancing the foreign exchange earning capacity of Nigeria. Simultaneous with this awareness is the growing concern of adherence to standard in order to maintain a reputation in the export market. It is therefore imperative that quality and standards are necessary conditions that must be given adequate attention in order to ensure the sustenance of Nigeria's competitiveness in the global market.

Nigeria is very popular in the area of production and export of top quality produce like Cocoa, Groundnut, Cotton, Gum Arabic, Sesame seed, Rubber, Ginger, mangoes, pineapples, coffee and host of others. Export markets for these products exist in USA, European Union, Gulf States, Japan, Singapore, China etc. Nigeria also has an added advantage over major Agricultural producers and exporters in the Eastern and Southern Africa in terms of fertile land, proximity to traditional and terminal markets in Europe by Air or by sea.

The advantages are numerous but the question has been whether Nigeria has succeeded over the years to translate this comparative advantages into gains. This brings us into the problem of "Quality" and "Standards". While Quality deals with the inherent nature of the product, standards reflects the "in use" requirements imposed by the local environment which may require modifications of the product. (Sasore, 2004)

A prominent feature of Nigeria's external sector has remained basically the same since 1960. The sector is characterized the dominance of a single export commodity. In the decades of the 1960's and 1970s the Nigerian economy was dominated by agricultural commodity exports. Such commodities included cocoa, groundnut, cotton and palm produce. From the mid-1970s crude oil is of the light and sweet type and is highly sought after in the international oil market.

The export of crude oil now constitutes about 90% of total exports. The performance of the non-oil export sector in the past two decades leaves little to be desired. The policy concern over the years has therefore been to expand non-oil export in a bid to diversify the nations export base. The diversification of the Nigerian economy is necessary for important reasons. Firstly, the volatility of the international oil market with the attendant volatility of government revenue gives credence to any argument for diversification of exports. Secondly, the fact that crude oil is an exhaustible asset makes it unreliable for sustainable development of the Nigerian economy.

This paper attempts to study the performance of non-oil exports on economic growth and proper solution to the over reliance on revenue from oil export.

Objective Of Study

The objective of this study is to examine the economic effect of overreliance on Oil export and also try to find role played by authorities to encourage the participation of non oil export both by the private and public sectors.

Methodology

In this paper, our task is to examine the economic effect of overreliance on Oil export and also try to find role played by authorities to encourage the participation of non oil export both by the private and public sectors. In doing so, the authors made use of regression analysis to measure the effect of non oil export on the nation's Gross Domestic Product (GDP).

Literature Review

The development of the export sector has been shown to be critical to the growth of a developing nation like Nigeria's. Leonidon and katsikeas (1996) postulate that export expansion improves economic development but requires incentives in the area of finance in developing nations. Zinkota (1994) states that export performance is important because it allows for accumulation of foreign exchange reserves, increased employment level, Squire and waters (1990) and Terpstra and Sarathy (2000) concluded that export growth increases the corporate profit, strengthens competitive edge, and resource.

According to Ajakaiye (1987) in examining the structure and growth of non-oil export since the late 1980s, it is pertinent to compare the situation with those that prevailed prior to the commencement of Structural Adjustment Programme (SAP).

Oyediji, (1986) prior to the mid 1980s, policies about agriculture prices were specially rigid, often amounting to revaluation of the naira led to the discouragement of the agricultural export. In the same vain, pegging of interest rate were mostly beneficial to the "big" borrower farmers, Ojo (1989). The domestic prices paid to export crop producers relative to the external prices reared by the erstwhile commodity boards were low, virtually amounting to implicit taxation or negative projection of farmers, Abalu (1975).

However, a number of empirical studies which have investigated the export-led-growth hypothesis, have found that exports have been instrumental to Nigeria's growth performance suggesting that in Nigeria export-led-growth hypothesis holds, falana (1979), Langley (1968), Olomola (1998), Ekpo and Egwaikhide (1994). Amsden (1989), describes in detail the measures the south Korea government used in trade protection and trade promotion such as selective credit subsidies, export targets, public ownership of banking sector, export subsidies and price control. This is to some extent popular in Nigeria.

Nigeria is one of the founding members of Economic Community of West Africa States and the World Trade organization and signatory of the Lome Convention Ogunkola and Oyejide (2001) despite these efforts non-oil exports have dwindled in the period of great openness. There are only a few empirical studies on the impact of global integration on non-oil export in Nigeria. However, a number of empirical studies which, have investigated the export-led growth hypothesis, have found that exports have been instrumental to Nigeria's growth performance suggesting that in Nigeria export-led growth hypothesis holds Fajana (1979), Langley (1968), Olomola (1998), Ekpo and Egwaikhide (1994). The introduction of the index of openness, that is, $(\text{export} + \text{imports})/\text{GDP}$ revealed a negative relationship between output growth and openness Oladipo (1998), Olomola (1998). Ogunkola and Oyejide (2001), in their study of market assess for Nigerian exports in the European Union (EU) found that the impact of commodity specific and the generalized trade liberalization have remained minimal.

Given this scenario, the paper posits that the dependence of the Nigerian economy on the world market for the supply of industrial and agricultural inputs as well as expertise for industrial and agricultural production is likely to be reinforced with the implementation of the terms of the WTO agreement.

The Growth Of Non-Oil Sectors

The Nigeria economy is highly dependent on proceeds from oil, which constitutes over 90% of total foreign exchange earnings required from financing several national development projects. Invariably, whenever oil prices rise or fall, the fortune of increased/reduced revenue will automatically manifest itself on the economy of Nigeria.

Also, the Nigeria Agricultural sector has always been expected to perform the roles of providing employment for the labour force, staple foods and raw materials for domestic and export needs. Until the 1970s, Nigeria depended mainly on agriculture for its export revenue. In 1960, the contribution of agriculture to foreign earnings was about 83% from 1960 - 1970, the export crop sub-sector contributed on the average 58.4% annually to the total foreign exchange revenue. Nigeria experienced substantial capital inflow largely in the form of oil sector earnings. The large oil revenue coupled with the accumulation of reserves in major foreign currencies became enabling factor in the decision to revalue the naira. Adeyemi (2004).

Nigerian Export Promotion Council (NEPC)

The Nigerian Export Promotion Council (NEPC) was established through the promulgation of the Nigerian Export Promotion Council Act No. 26 of 1976 and formally inaugurated in March, 1977. This Act was amended by Decree No. 72 of 1979 and further amended by the Nigerian Export Promotion Decree No. 41 of 1988 and complemented by the Export (Incentives and Miscellaneous Provisions) Decree No. 18 of 1986. Furthermore, the Nigerian Export Promotion Council Amendment Decree No 64 of 1992 was promulgated to

enhance the performance of the Council by minimizing bureaucratic bottlenecks and increasing autonomy in dealing with members of the Organised Private Sector. (NEPC).

Export procedures

It has been observed that the world's economic and scientific development and progress is towards increasing the need for documentation rather than decreasing it. To make a success in export trade, the exporter must adopt an integrated systems approach a well-defined export price and payment policy. This approach must start right from the quotation stage when the price and offers are being made for presentation to the potential overseas buyer.

Correct documentation, therefore, is the lubricant of international trade and its importance cannot be overemphasised. Incorrect documents cause delays at ports when clearing the goods through customs, resulting in extra costs, failure to meet delivery dates and, in some cases, seizure of such goods. Unfortunately, some exporters fail to realise the importance of correct documentation and thus develop bad reputation for their export business. In order to save extra costs and possible delays at the point of import, the potential exporter should ensure that he is fully acquainted with all aspects of the actual procedure involved in getting the goods from factory/farm gate to the consignee. It is therefore, important to know what documentation will be needed to get the goods out of the country of production and into the foreign market with the least possible delay and expense. Also, it is necessary to know what special certificates are required e.g. health, sanitary, free sale and the like.

Classification of goods

Most countries have now adopted the Customs Co-operation Council Nomenclature (CCCN) formerly known as the Brussels Trade Nomenclature (BTN). The CCCN is comprised of 99 chapters with many sub-divisions in each chapter. The first four digits are similar in all countries using the CCCN and EEC countries the first six digits are similar but any further breakdown in code numbers may vary from country to country. Any export should be familiar with this trade code to ensure effective communication between him and his buyers. Though codification of products in trade can hardly be misunderstood.

The Federal Government of Nigeria issued new guidelines for both exports and imports in 1996. The new guidelines for export were aimed at ensuring strict adherence to accountability and transparency in the conduct of international business by Nigerians as a first step towards building a good image for the country. The objectives would be achieved by ensuring that the quality and quantity of all exports as well as the true value of goods to the consignee tally with the claims on all accompanying documents. The new guidelines have been used to update and review the publication on export procedures and documentation in Nigeria. (NEPC).

Youth Militancy and Conflict in the Niger Delta

The Niger Delta has an estimated population of 29 million people, the bulk of which lives in rural fishing and farming communities. Their socio-economic conditions are worrisome as 73% of the people lack access to safe drinking water, about 70% of households lack electricity, 94% of the population lack access to telephones and primary school enrolment rate is below 40% (Ibeanu 2006). These situations show that poverty and underdevelopment remains widespread in the Niger

Delta in spite of its abundant resources (Okoko 2004). The Niger Delta in Nigeria is one of the world's largest wetlands and the largest delta in Africa.

The context of the Niger Delta struggle is defined by the Nigerian national question with grave implication for conflicts. Dimensions of conflicts in the Niger Delta include conflicts between the multi-national oil companies, the Nigerian State and the host communities as well as intra and inter communal conflicts. Complexities of these conflicts stem from contradictions in the exploitative production systems and hostile exchange relations between two major coalitions comprising the multi-national oil companies and Nigerian State on one hand and the youth and peasant communities on other hand. The major oil companies in the area include Shell, Exxon-Mobil, Elf Aquitaine, Chevron-Texaco, Eni-Agip, and TotalFinaElf (Iwayemi 2006; Ibeanu 2006). Their operations are principally organized as joint ventures with the Nigeria National Petroleum Corporation (NNPC). In the 1970s, the Nigerian governments used indigenization policy to acquire 60% equity in the major multinational oil companies and 80% in Shell-BP. Some multinational oil companies however abandoned their operations in Nigeria due to the implementation of the policy. The attendant decrease in foreign investments and the perceived failure of indigenization policy motivated the Nigerian governments to move towards partial deregulation and commercialization of various operations of the NNPC, which was commercialized with the creation of 11 subsidiaries in 1988. The governments have shifted emphasis from ownership of the petroleum industry in favour of complete deregulation of the industry and selling of NNPC. However, petroleum sector workers embarked on strike in August 2002 to protest against government attempt to privatize the NNPC owned refineries. The Nigerian governments were however reputed for curtailing labour rights and weakening labour movements as an important part of their economic strategies (Okafor 2007).

WTO Tariff Bindings and Nigeria's Commitments

The WTO negotiations led to the promulgation of general rules that apply to all members, and specific commitments made by the individual governments. These are listed in documents called "schedule of concession". For goods in general these consist of maximum tariff levels. For agriculture, they also include tariff quotas, limits on export subsidies and some kind of domestic support (WTO 2003a). A country can change its bindings, but after negotiating with its trading partners, which could mean compensating them for loss of trade. The Uruguay Round of Multilateral Trade Talks has so far achieved an increase in the amount of trade under binding commitments. In agriculture, 100% of products now have bound tariffs. The result is a substantially higher degree of market security for traders and investors (WTO 2003a).

The Round Agreement has achieved an increase in the number of import whose tariffs rates are "Bound". The increase for developed countries was from 78% to 99%. For developing countries, the increase was considerable from 21% to 73%. Economies in Transition from central planning increased their binding from 73% to 98%. According to WTO assessment, this all amount to a substantially higher degree of market security for traders and investors (WTO 2003a).

Table 1: Incentives Schemes Adopted to Boost Non-Oil Exports in Nigeria

| Incentive scheme | Operation Agent | Objective and Remark |
|--|---|---|
| 1. Refinancing & discounting facility (RRF) and foreign input facility | CBB/NEXIM | To provide liquidity to banks in support of their export finance business directed at export promotions and development |
| 2. Current retention | CBN and the Commercial/merchant Banks | To enable exporters to hold export proceeds in foreign currency in their banks |
| 3. Tax relief on export earned by banks on export credit | Banks and Federal Board of Inland Revenue | To encourage banks to finance export by reducing their tax burden. |
| 4. Export credit guarantee and insurance scheme | CBN/NEXIM | Assists banks to bear the risks in export business and, thereby facilitates export financing and export financing and export volumes. |
| 5. Duty drawback Scheme | Customs Department; standard Organization of Nigeria, Nigeria Export promotion Council (NEPC) commercial and merchant banks | To reimburse customs duty paid by exporters on imported input used for export production. This has not been widely used by exporters due to the cumbersome procedural requirements involved, although the fund has been increased to \$50 million |
| 6. Export expansion NEPC grant | | To encourage companies to engage in export business rather than domestic business: especially exporters who have exported N50,000 worth of semi-manufactured or manufactured products. |
| 7. Export price adjustment | NEPC | This is a form of export subsidy designed to compensate exporters of products whose foreign prices become relatively unattractive, due to factors beyond their control. |
| 8. Subsidy scheme for use of local raw materials in export production. | NEPC | To encourage exporters to use local raw materials in export production. |
| 9. Export development fund | NEPC | To assist exporters in partly paying the costs of participation in trade fairs, foreign market research e.t.c. |
| 10. Abolition of export licensing | Federal ministry of commerce & Tourism | To remove administrative obstacles from the export sector as much as possible. |
| 11. Supplementary allowance in favour of pioneer companies | Federal ministry of commerce & Tourism | To extend supplementary incentive to pioneer companies that export their products |
| 12. Accelerated depreciation and capital Allowance | Federal ministry of commerce & Tourism | To extend supplementary incentives to industrial organization for export of their products |
| 13. Manufacturing Bond Scheme | Federal ministry of commerce & Tourism | To assist potential exporters of manufactured product to import raw materials duty free for production of exportable products. |
| 14. Export Liberation Measures Buy back arrangement | Federal ministry of commerce & Tourism | To liberalize, and promote export trade |
| 15. export processing Zone | Federal ministry of commerce & Tourism | Opened in mid-1996 in Calabar, to facilitate and enhance exports. |

RESEARCH METHODS AND MODEL SPECIFICATION

Data were gathered from secondary source i.e. from the Central Bank of Nigeria (CBN) Annual reports. The data used covered a period of 23 years (1980-2003).

The method of analysis was based on Regression analysis using coefficient of multiple determinant (R²). The value of R² was obtained for the oil exports and non-oil export for the period 1980 to 2003.

$$GDP = a_0 + b_1OE + b_2NOE + mt$$

Where

GDP = Gross Domestic Product

OE = Oil Export

NOE = Non-Oil Export

mt = Error Term

Analysis and Findings

Model 1 - 1980 - 2003

GDP - Dependent Variable

Oil Export - Independent Variable

R² = 0.945

Model 2 - 1980 - 2003

GDP - Dependent Variable

Non-Oil Export- Independent Variable

R² = 0.780

The R² values for models 1 and 2 represent the proportion of the variation in the Gross Domestic Product that is explained by the variation in the oil export and non-oil export from 1980 to 2003.

The R² values for models 2, 4 and 6 represent the proportion of the variation in the Gross Domestic Product that is explained by the variation in the non -oil export from 1980 to 1994, 1995 to 2003 and 1980 to 2003 respectively.

Table 2: Basic External Data of Nigeria (1980-2003) (N' Million)

| Years Factor Cost | GDP Current | Oil export | Non-oil Export |
|------------------------------|--------------------|-------------------|---------------------------|
| 1980 | 49,632.3 | 13,632.30 | 554.40 |
| 1981 | 50,456.1 | 10,680.50 | 342.80 |
| 1982 | 51,653.40 | 8,003.20 | 203.20 |
| 1983 | 56,312.90 | 7,201.20 | 301.30 |
| 1984 | 62,474.20 | 8,840.60 | 247.40 |
| 1985 | 70,633.20 | 11,223.70 | 497.10 |
| 1986 | 71,859.0 | 8,368.50 | 552.10 |
| 1987 | 108,183.0 | 28,208.60 | 2,152.00 |
| 1988 | 142,618.0 | 28,435. 40 | 2,757.40 |
| 1989 | 220,200.0 | 55,016.80 | 2,954.40 |
| 1990 | 271,908.0 | 106,626.50 | 3,259.60 |
| 1991 | 316,670.0 | 116,858.10 | 4,677.30 |
| 1992 | 536,305.10 | 201,383.90 | 4,227.30 |
| 1993 | 688,136.60 | 213,778.80 | 4,991.30 |
| 1994 | 904,004.70 | 200,710.20 | 5,349.80 |
| 1995 | 1,934,831.0 | 927,565.30 | 23,096.10 |
| 1996 | 2,703,809.0 | 1,286,215.90 | 23,327.50 |
| 1997 | 2,801,972.60 | 1,212,499.40 | 29,163.30 |
| 1998 | 2,721,178.40 | 717,786.50 | 34,070.20 |
| 1999 | 3,313,563.10 | 1,169,476.9 | 19,492.90 |
| 2000 | 4,727,522.60 | 1,920,900.40 | 24,822.90 |
| 2001 | 5,374,334.80 | 1,973,222.20 | 28,008.60 |
| 2002 | 6,232,243.60 | 1,787,622.10 | 95,046.10 |
| 2003 | 6,061,700.0 | 2,794,754.2 | 95,092.50 |

Source: Central Bank of Nigeria Statistical Bulletin-2004

Findings and Discussion

From our analysis above, it could be observed that the contribution of non-oil export during the first period i.e. 1980 - 1994 was not impressive compared with the contribution of oil export during same period. There was slight improvement in the performance of non-oil export during the second period i.e 1995 - 2003 compared with contribution of oil export during same period. Below is the summary of the contribution of oil export and non-oil export to the changes that occur in the GDP.

Table 3

| | 1980 -1994 | 1995 – 2003 | 1980 -2003 |
|-----------------------|-------------------|--------------------|-------------------|
| | % | % | % |
| Oil Export | 90.7 | 75.8 | 94.5 |
| Non-Oil Export | 77.7 | 56.4 | 78 |

The overall performance of non-oil export cannot be compared with performance of oil export, but there has been an appreciable improvement especially in the second period of analysis. This is largely due to the policies of the various tiers of Government to develop the non-oil sector due to the fluctuations in the International oil market and the incessant conflicts in the oil producing areas of Nigeria.

Recommendation and Conclusion

The government needs to invest in the non-oil sector adequately so as to be able to strike a balance, between the oil and non-oil sector and other sectors of the economy. In order to achieve this, the following steps must be taken.

- Investments in agriculture i.e. cultivation of vast plots of land, for the farming of crops, in areas, where these crops thrive most e.g. sugarcane (for the production of sugar) in Bacita, Rubber in Edo and adequate management/administration should be provided for these crops, wherever they planted, so that high revenue yields can be got from agricultural products' exports.
- The government should try to develop the mining of solid minerals. This entails the training of people (Engineers, Economists, Scientists, and Geographers etc) for the activity of mining. The mineral output should be well-processed so as to meet international market standards. Research has shown that if well developed, this sector can provide high revenue amounts for the federal government of Nigeria.

Finally, this paper has shown that the non-oil sector can contribute more to the export-earnings of Nigeria than the oil sector if properly managed. The policies of the various tiers of Government are geared towards the development of the non-oil sector due to the fluctuations in the International oil market and the incessant conflicts in the oil producing areas of Nigeria.

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KNOWLEDGE IN ENTERPRISE: THE ROLE AND PERFORMANCE MEASUREMENT

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Abstract

The current entrepreneurial environment increasingly makes demands on the recognition of driving forces influencing value creation. Intangible assets, first of all knowledge are becoming such driving forces. The paper emphasizes the role of knowledge in enterprise also in continuity with the management of new competences on the new global market. In brief, it presents some methods of measurement of intangible assets performance, the part of which is knowledge. In conclusion the paper emphasizes requirements for monitoring and valuation of intangible property performance with the emphasis on knowledge capital.

Keywords: *performance management, knowledge, intangible assets, enterprise, viewpoint*

1. Introduction

A newly arising competitive environment exerts pressure on the re-evaluation of company reporting character and on making changes in the systems of performance measurement. Performance and its monitoring and maintaining have become not only the instrument of competitiveness but also the precondition of a company existence.

IMA (Institute of Management Accountants) has surveyed opinions of its one thousand and half members on the systems of performance measurement (Denton, 2002).

In the IMA survey from 2001 it is said that 80 % of its respondents announced the implementation of changes in the systems of performance measurement during the last three years. The changes varied from radical (rejecting the current systems) to incremental ones (delivering or eliminating of measurement). 33 % of respondents mentioned a change as the main renovation of the system of measurement. 31 % of those respondents said that their system of measurement was less than adequate or even insufficient for supporting company's goals and initiatives. Only 15 % of them considered the systems of performance measurement as very good or excellent for a communication strategy. The users evaluated the balanced scorecards much better.

Key challenges for performance measurement seem to be intangible assets including also knowledge. In the IMA survey 60 % of the respondents thought the innovation to be part of company's statement about its mission. Yet, more than 50 % of them indicated the system of measurement as insufficient or less than adequate in that area. In total, less than 10 % of the respondents considered the indices of performance for intangible indices including assessment of knowledge as very good or excellent.

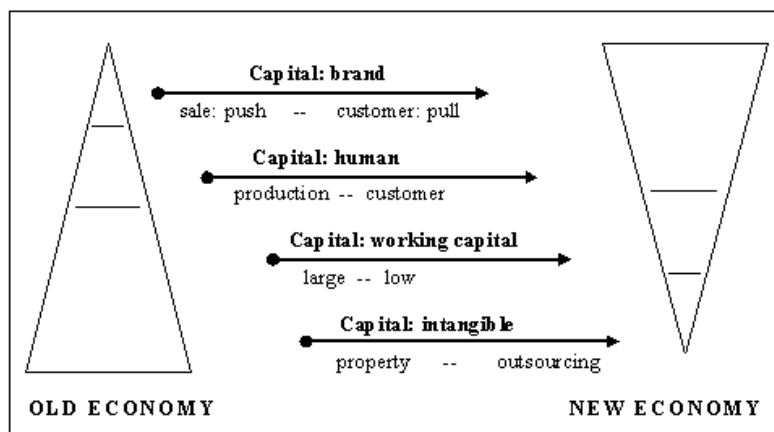
Also reports from companies dealing with performance evaluation – the Institute of Authorized Accountants in England and Wales (ICAEW) (www.icaew.co.uk), the Centre for Tomorrow's Company (CTC) and the Centre for Performance Measurement (www.tomorrowcompany) show the support to non-financial measurement with the focus on knowledge. Also the research done by PricewaterhouseCoopers called ValueReporting (www.valuereporting.com) came to the same conclusion. There is no doubt that the above-

mentioned reports would deserve more attention. Because of the contribution's extent, however, only the above-mentioned conclusions have been presented. More detailed information can be found on the indicated web pages.

2. A new entrepreneurial environment increases the role of knowledge in business

A new competitive environment is characterized by the shift in the structure of company's sources. The following picture explains a growing importance of intangible property and changes in sources.

Figure No. 1: Company de-capitalization



Source: Ruthner, R., 2002

Prahalad (1998) aptly describes a newly arising competitive environment. He identifies eight discontinuities accompanying the new economics: environment-friendly behaviour, putting a limit on intermediation, standards, distorted borders among branches, convergence, variations in demand, deregulation and privatisation, globalisation. Those discontinuities will influence companies in a different way but generally all of them will have to include globalisation impacts into their decision-making, they will be forced to form alliances, even though sometimes temporal only, they will have to accept speed as the element accompanying all processes, and they will be forced to re-evaluate their “entrepreneurial” model so that it would comply with the requirements of a new environment. Environment where enterprises leave existing role in society (profit only) to new wider view of corporation's functioning considering triple – bottom – line (Krymlakova, 2007). Primarily, they will have to lay a **considerable emphasis on acquiring** and the right **use of knowledge**.

The above-mentioned discontinuities will not be further dealt with because of the extent of the paper.

At managing discontinuities the managers will be confronted with new complex challenges. A company in the new environment has to apply **principles of knowledge management** to be able to cope with new competences. Managing competences on the new global market is a complex task having at least five various elements (Prahalad, 1998):

1. Obtaining the access to new knowledge and its acquiring
2. Integration of many various fields of knowledge

3. Cooperation within various cultures overcoming considerable distances
4. Learning of how to quit inappropriate things – to overcome a routine
5. Coordinated applying of competences within the framework of many business entities

Creation of new competences, their selective using and the protection of the current competences act as a big challenge as far as knowledge management is concerned both from the view of desired intellectual abilities and workforce's knowledge, and from the view of organisation. Minimally they include the following requirements: investment into bringing people of various cultures closer together in a company, improving the knowledge of languages, keeping a considerable volume of documentation but not bureaucracy itself, a systematic professional training focussed both on the analytical and experimental nature of management.

3. Knowledge as part of intangible enterprise values

Knowledge management is closely connected with the intellectual capital. Sveiby thinks them “twins” – “two branches of one tree” (Sveiby, 2003b). The difference between the management of intellectual capital and knowledge management is clearly expressed by Sveiby's definition of knowledge management: “the art of creating values from intangible property” (Morris, 2003).

The difference between intangible assets and intellectual capital used to be defined rather vaguely. According to the definition by the Organisation for Economic Cooperation and Development the intellectual capital is part of company's overall intangible assets. Others understand intangible assets as “goodwill” and the intellectual capital as part of goodwill (Davies, Waddington, 1999).

Leif Edvinsson, one of the creators of Skandia Navigator model defines intellectual capital as “**knowledge that can be converted into values**” (www.skandia.com). While creating “Navigator”, he emphasized a constant ownership of knowledge represented by inventions, thoughts, software, and patents, which he included just into intellectual capital. In “Navigator” he defines also human capital but at the same time he emphasizes a necessity of transforming it into intangible, intellectual property, which he considers a basic task for managers of intellectual capital or knowledge managers.

The Organization for Economic Cooperation and Development describes intellectual capital as “economic value of two categories of company's intangible property: organisation (structural) capital and human capital” (Guthrie, 2001). Structural capital consists of elements such as software property, distribution networks and supply chains. Human capital includes human resources inside a company (employees) and external sources (above all customers and suppliers).

4. Methods of intangible assets performance measurement including knowledge

Luthy (2002) classifies four approaches to the measurement of intangible assets:

Direct methods of intellectual capital valuation

As soon as particular components of intellectual capital are identified, they are evaluated individually or by the aggregated coefficient. The result is a financial evaluation of intangible assets (e.g. Technology Broker).

Methods of market capitalization

They compare differences between a market value of the company and its value for shareholders. This difference is considered as intellectual capital or intangible property.

Methods based on property profitability

A company compares the value of property profitability with an average in the branch. Multiplier difference is the value created by tangible property and the income from intangible property. Costs of capital or the rate of interest are taken into account (the EVA method can be part of such approach).

Scorecard methods

Various components of intangible assets or intellectual capital are incorporated in scorecard together with their driving forces initiating their development (e.g. Skandia Navigator, IC-index, Intangible Assets Monitor, Balanced Score Card).

The methods offer various advantages. The methods of market capitalization and the methods based on property profitability are useful for a merger or acquisition and/or for the assessment from the standpoint of stock market. They can be used for a comparison of companies within the same branch because they illustrate well a **financial value of intangible property (as well as knowledge)**, which is a feature attracting the attention of top management. Their advantage is that they are clearly communicated with budgeting and accounting. The disadvantage is that the effort to transform intangible assets into financial means can lead to lightweight or false conclusions not corresponding to reality.

The advantage of methods of direct evaluation or scorecards is that they will create a **more integral**, easier obtainable picture about company's soundness than a mere using of financial indices and also the fact that they are easily **applicable** at any hierarchical level. Their disadvantage is that the indices are closely connected with each other, and they have to be divided into particular levels and for particular purposes, which make a mutual comparing rather difficult. Also the implementation of those methods might face up to the misunderstanding on the part of managers who are still accustomed to think only in terms of finance.

The article Measuring Intellectual Assets (www.montague.com) presents another classification of techniques. Again, due to the extent of my paper that classification will not be further mentioned.

For purposes of this paper two following methods of intangible property valuation with the focus on knowledge assessment will be presented.

4.1 Knowledge Assets Map

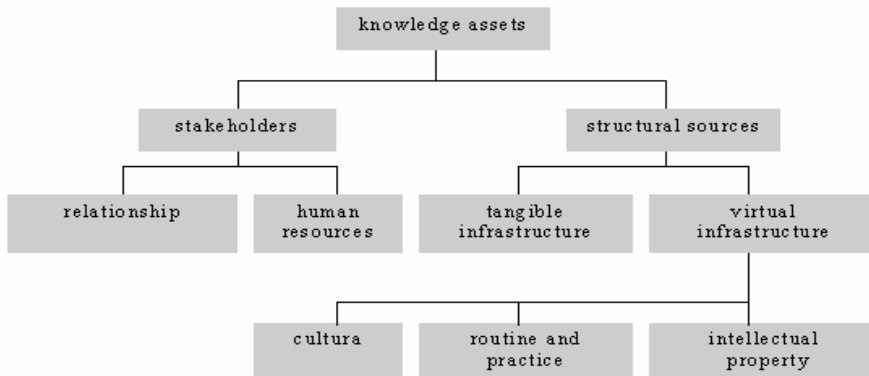
A model assessing intellectual property is especially useful for purposes of accounting and external reporting even though they do not inevitable provide managers with an instrument of company's **knowledge property assessment**. The map provides managers with a broader framework for knowledge assessment both from the external and internal viewpoint (Marr, B., Schiuma, G., 2001). It comes from a widespread interpretation of intellectual capital that includes overall knowledge assets of a company. The map provides a framework that will spread the promotion of understanding the structure of knowledge assets. It will allow critical areas of knowledge to be identified and defined and facilitates designing indices for knowledge capital appreciation.

The map is based on knowledge assets interpretation as a sum of two company's sources: stakeholders and structural sources. This difference reflects two main components of a company, its actors who can be internal or external ones in relation to the company, and its basic components – elements creating the basis of company processes. The following picture clarifies the hierarchy of knowledge assets and its classification into subclasses.

Stakeholders' sources are divided into relations with stakeholders and human resources. The first group identifies all external actors while the other one represents internal participants. Structural sources are divided into physical and virtual infrastructures that refer

to the appropriate tangible and intangible nature. In the end the virtual infrastructure is further divided into culture, practice and routine, and intellectual property.

Figure No. 2: Knowledge Assets Map



Revised from: Marr, B., Schiuma, G., 2001

Six categories of knowledge assets identified by the Map:

- Relations with stakeholders - include all forms of relations between a company and its stakeholders. These relations may concern licence agreements, partner's associations, financial relations, and contracts and measures about trade channels. They also include customer's loyalty, the name and a good reputation of the company that represent the basic connection between a company and its stakeholders.
- Human resources – include knowledge provided by employees in the form of qualifications, motivation and loyalty as well as in the form of advice or a tip. Know-how, technical expertises, abilities to solve problems, creativity, education, attitude and enterprising spirit are considered other key components (Horvathova, 2008).
- Physical infrastructure – includes the whole infrastructure of property including information and communication technologies such as computers, servers and other hard systems.
- Culture – includes corporate culture and management philosophy. Among some significant elements there are company values, the way of building a network of relationships, the set of objectives, defining a company mission.
- Work and routine – includes internal work, virtual networks and a regular procedure, which are unexpressed rules and procedures. Some key elements are: handbooks on procedures allowing procedures and rules to be systematically classified, databases, unexpressed rules of behaviour, a managerial style. Practice and routine will determine how to control processes, and in which way a process of workflow goes through a company.
- Intellectual property is a sum of patents, copyrights, trademarks, makes, registered designs, trade secrets and processes, the ownership of which has been awarded to a company by the law.

4.2 Intangible Assets Monitor

In the model developed by Sveiby in 1997 the expression intangible assets is used rather than intellectual capital (Sveiby, 2003a). In particular, three categories of intangible assets are

taken into consideration. They are: intangible assets associated with the internal structure, associated with the external structure and assets represented by people's competences.

Internal structure comprises intellectual property, patents, copyrights, corporate culture, managerial processes, network of channels.

External structure comprises relationships with customers and suppliers.

Competencies of employees are associated with human capital taking into consideration skills instilled in individuals working in a company.

In order to define indices for valuation of intangible assets in each of the above-mentioned categories the Monitor identifies three critical areas of measurement: growth, performance, and stability. In each area a company defines key indices of specific intangible assets valuation.

The first step in the materialization is to determine who is interested in results. Measurement can be performed for the external or internal presentation. In the first case the indices usually describe the company as precisely as possible in order to let stakeholders know what the value of the company is. In the other case the measurement was undertaken in order to provide managers with a knowledge information system. Contents of two various presentations are different. Internal information should predominantly centre on a flow, change and data control. Measurement for external needs should be able to inform on key indices and provide explanation of company intangible values

A structure of the monitor is depicted in the following picture. Its working out together with examples of indices is presented in the Enclosure No 1.

Picture No. 3: Intangible Assets Monitor

| Enterprise Market Value | | | | |
|-------------------------|-------------------|--------------------|--------------------|-----------------|
| | Intangible assets | | | Tangible assets |
| | Competences | Internal structure | External structure | |
| growth | | | | |
| innovation | | | | |
| performance | | | | |
| stabilization | | | | |

Revised from: Sveiby, 2003a

5. Conclusion

Nowadays, it is possible to open the annual report of every large company, check data in accounting statements and find out the facts about physical property¹. But it is possible to find out very little or even nothing about the property that is a real driving force of values creation.

Rajat Gupta, a director of Mc Kinsey consulting firm, foretold that during the period of ten years there would be at least one airlines company having almost nothing as far as the physical property (tangible) was concerned and instead it would rely on virtual intangible assets: a brand (make), the system of making reservation, the right to land and databases (Neely, 2002).

¹ In the Czech Republic a legal duty exists for all subjects registered in the trade register to meet the Collection of documents kept at the register court among others by financial statements. The Collection of documents is accessible for the public. The easiest way of how to obtain information is to search www.obchodnirejstrik.cz

Recently it has been very often emphasized that a tangible property is not the only property of a company. The research led by Arthur Andersen firm compared the market value with the accounting value in 3.500 American companies over two decades. They found out that in 1978 the accounting value typically reached 95% of the market value while in 1998 the accounting value was at the level 28% of market value. Why?

A partial reason is growing recognition of knowledge work importance. For example, Oracle (Morris, 2003): in August 2000 its market valuation was 254.509 million of dollars, which was a 39,4 times higher value than a company property. How can it happen? How can be the company with 6.460 million dollars of tangible property valuated at the market at the rate of 254.509 million? Of course, the answer can be found in company intangible assets – a brand, its position on the market, abilities, knowledge etc. A company is far more than a mere sum of tangible property (Vokounova, 2006). In the current, information-orientated society intangible assets often overweigh company's tangible property. A question arises, how the manager and the investor can monitor whether the value of intangible assets is increasing or decreasing. For that reason a requirement for recording and monitoring of intellectual capital performance with the emphasis on knowledge capital is activated.

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ENCLOSURE NO. 1
INTAGIBLE ASSETS MONITOR: MATRIX OF INTAGIBLE ASSETS
WITH EXAMPLES OF METRICS

| | Company market value | | | |
|--------------------------------|---|--|---|------------------------|
| | INTANGIBLE ASSETS | | | TANGIBLE ASSETS |
| | People's competences | Internal structure | External structure | |
| Metrics of growths and renewal | Professional experience Education attained Costs of training Workforce fluctuation | Investments into the internal structure Customers' contribution to systems/processes developing Investments into information systems | Profitability per customer Growth | |
| Metrics of innovation | Costs of education Diversification | A share of new products or services A number of newly implemented processes | A share of sales to new customers | |
| Metrics of performance | The ratio of professions in a company Added value from every profession Driving force effect Profit per employee | The ratio of supporting employees Sales per one supporting employee Corporate culture | Index of customer's satisfaction Index victory/loss Sales per one customer | |
| Metrics of stability | Average age A number of seniors A ratio of wages amounts A rate of turnover for particular professions | The age of organization Fluctuation of supporting employees The rate of newly hired employees | A share of big customers The age structure of customers The rate of loyal customers Frequency of repeated orders | |

Source: Sveiby, 2003a

THE PRACTISES OF FISCAL POLICY FOR ECONOMIC STABILITY IN TURKEY (AN ECONOMETRIC STUDY: 1985 – 1999)

Engin ÖNER

Abstract

In order to achieve to main macro aims such as economic stability, economic development and equitable income distribution, the fiscal policy has been used too. Public expenditures, public revenues, public borrowings and budget applications are important tools of fiscal policy to obtain economic stability. In our study which aims to determine whether or not the economic stability is obtained by fiscal policy in Turkey in a time period between 1985-1999; it is revealed that the fiscal policies regarding to internal and external borrowing and interest payments were unable to obtain economic stability and that they have increased the inflation; with another statement, those following fiscal policies for inflation fighting weren't successful. General view of tax, expenditure and budget policies support this result as well.

Keywords: *Fiscal Policy, Economic Stability*

I. Introduction

Nearly in every country, economy policy instruments have been used such as fiscal, money, foreign trade, price and employment to achieve spesific macroeconomic goals (full employment, production, price stability, payment balance, development and redistribution of income).

Fiscal policy is considered as; “mostly to achieve to macroeconomic policy goals, it is to reconcile of the changes which government modifies in taxation and expenditure programs (Shaw, 1975:624) or “ to regulate the full employment price and total demand, to be used of instruments such as government expenditures, taxes and debt management (Hacholiades, 1994 :624) or “ all of fiscal policy instruments that government uses to effect the economic running” (Tanzi and Elgar, 1991: 14).

In another definition it is considered the fiscal policy as; “ in an economy, whole necessary regulations regarding in government expenditures and taxes” (Ataç, 1991:27) and it is defined such as; “the fiscal instruments which government holds, are to be used for protection of stabilized economic framework which is purified from cyclical fluctuation and for obtain the price stability, full employment, economic growth and development, redistribution of income and worth .

Consequently, government's interference to the economy is via fiscal policy, here the government aims to obtain optimum resource allocation, economic stability, payment balance and equal income redistribution (Coşkun, 1988:28). To achive these goals in the economy, goverment benefits from government expenditures, incomes, depts and budget as fiscal policies.

II. Economic Stability And Fiscal Policy

The fiscal policy, mainly, has been run by government budget, both the quantity and composition of public expenditures and incomes, and budget deficit or surplus are the important instruments of which the government can use to achieve the goal of fiscal policy to obtain the stability.

In economic stability, the functions of public expenditures are; when the inflation dominates through economy, to equal the total demand to total supply at full employment level, if economy is on balance, to protect this balance, on the contrary if economy is in deflation, to make the demand mass the good and services which economy produced at full employment level.

The tax policies, existing to decrease the demand in short term and to increase the supply in long term in inflation fighting, stimulate the productive investment to support the development, discipline the consumption and give way to applications those forefront the tax rebates, exemptions and exceptions to rise the economy in deflationary period.

III. An Econometric Study

A. Model Definition

In this study, it is examined the efficiency of fiscal policy to obtain the economic stability.

It is a well-known case that the public finance, in economy policy, is one of the instruments which is most affected by political criterions (Atiyas, 1996:16) and that the politicians can increase the government expenditures rather than the resources because the factors such as vote concerns etc in overcompetitive case. And this causes to public deficits and financial problems.

Turkish economy is taken to a vicious circle that is caused by high inflation. Because the inflation is very high, in public borrowing, nominal and real interest rate while is being so high, the borrowing term is very short. By the increasing of interest rate, public deficits rise and cause the inflation rate stands at high level (Kumcu, 1998:18).

It is known that the inflation reduces the real value of public borrowings (McMillin, 1986:257-269). However, with this logic, it can't deduce the consequences that the public debts are melt in the course of time, consequently, that increasing of public borrowing is an affirmative policy in inflationary periods. Because, at one side the chronic inflation decreases the public incomes, at the other side prevents the reduction of public expenditures. Under those conditions, the public sector borrowing from continuously increasing market interest rate; get into interest-budget deficit-borrowing and interest burden spiral (Önder vd, 1993:42).

Among main reasons of PSBR (Public Sector Borrowing Requirement) which is the one important issue of Turkey, are economic intervention of government and excessive extent of public sector, rapidly population growth rate, underdevelopment and savings gap because government determines development rate become high, present of non-financial public enterprises, inconsistency between tax system and socio-economic status (Akalın, 1994:5).

In a study (Akat, 2000: 265-282) where maintained that the high inflation prevents public sector having a wide dimension, it is stated that high inflation rate worsens income inequalities further, rises the unemployment rate in urban and rural areas and along this process, causes an erosion on society's moral and ethic values in last two decades, in Turkey.

Furthermore, the hypothesis would be advantageous for economic development, is refused by empirical findings (Fisher, 1996:34)and; economic results has shown that there is a negative correlation between inflation rate especially with double digit and economic growth.

There are some studies which show there is an affirmative relationship between interests and budget deficit in a literature (Dua and Arora, 1995:23-31), (Ewing and Yanochik, 1997:199-201), (Cebula, 1999:489-495); suggest the budget deficits are increased due to interests (Cebula and Saltz, 1997: 19-27) and state the increment in budget deficits which occur because of over-borrowing, would increase the interest rate (Cebula and Belton, 1993:188-209).

Continual increasing public deficits have significantly limited the benefits from liberalization and extrovert of economy. Especially, entering of public policy into an expansionary tendency contrary to expectations, causes to occur an unstable structure based on domestic demand and the increased price increments to become chronic.

In an amprical study (Özmen and Koğar, 1998:107-127), which is done about sustainability of budget deficits in our country where we are accustomed to chronic budget deficits, it is pointed out that the strong sustainability condition of public policy based on budget deficits wouldn't be obtained , on the contrary week sustainability condition would be; however in the case of to insist on this fiscal policy, would be live the issues.

In some studies which research the relation between inflation and interest rate (Podkaminer, 1998:583-596) and (Calvo, 1992:55-71), it is put forward that efforts of high inflation reducing are generally related to the policies which occur at positive real interest rates; contrary to this, nominal interest rates often reaches to exorbitant levels.

Besides, it is claimed that an adequated high interest rate can be resulted in the unlimited price increment; whereas the gradual discounting in interest rates, by prompting the increase in production, would assist in reduction of inflation, on time (Calco, 1992: 55-71).

Into direction to these datas, , the answer of following questions are investigated. Namely;

Has it been obtained the economic stability with fiscal policies followed in Turkey during 1985-1999? In another manner, has the fiscal policies which followed through inflation fighting been successful?

To seek answer to those questions (taking into account the point of achieve to thirth montly datas), following hypothesies are set up and tested:

Hypothesis-1. Over-borrowing (external and internal borrowing, especially because of internal borrowings being short-term, unable to run in investments) policies increase the inflation

Hypothesis-2. Progressive expenditure policies (especially transfer expenditures and debt interest payments inside it) increase the inflation.

To test these hypothesies:

$$Y_t = \beta_0 + \beta_1 X_{1t} + \beta_2 X_{2t} + \beta_3 X_{3t} + u_t \quad (1)$$

Like this a linear inflation model is formed. Where Y_t is the wholesale price index representing the inflation, X_{1t} is the external borrowing, X_{2t} is the internal borrowing, and X_{3t} is the servicing in transfer expenditures.

B. Data and method

This study which aims to determine whether the economic stability is obtained or not by fiscal policy in Turkey in a time duration of 15 years between 1985-1999, is based on third montly data between 1985: 1-1999: 4.

The “Econometric Views” package program is used in analysies. The series which are tested in order to get econometrically meaningful relations among variables used in the model, must be stagnant series. Which is because of estimation of a regression equation without examining the characteristic of time series models, can cause misleading reasults, this case is called as “ false regression” in econometrical literature (Granger and Newbold, 1974: 111-120), (Madalla, 1992:238) or it is called “ falsified regression” (Gujarati, 1999. 724-726); before estimated the inflation model formed in equality (1), the charasteristics of time series models of data belongs to variables in the model are investigated. Thus, stagnant test is executed to each one variables.

With this purpose, it is determined that whether the variables in the model are stagnant through “ *Augmented Dickey-Fuller Test Technic*” (Dickey and Fuller, 1979: 427-431; 1981: 1057-1072). The process in ADF test technic is pointed out in following equality:

$$\Delta Y_t = \beta_1 + \beta_2 trend + \delta Y_{t-1} + \alpha_i \sum_{i=1}^m \Delta Y_{t-i} + \epsilon_t \quad (2)$$

In ADF unit root test which is used in that whether is $\delta = 0$ in estimated number (2) regression equation, in case of zero hypothesis is rejected, it is considered that it is stagnant at level value of variable Y, on the contrary it is not.

Considering the first differencies of a serie which is determined as whether stagnant or not at level value, above test process has been repeated for these values. This test is implementing for second or third differencies as well until the series are determined as stagnant. Consequently in second equation, comparing the tradational t statistic accounted for $\delta = 0$ regression equation, with critical values which are given by MacKinnon (MacKinnon, 1991: 90-94) and testing to general alternatives, provide the determination of the variable whether is stagnant at its tested level.

It is required for ADF test to give affirmative results, being far from the autocorrelation problem of estimated regression equation. In the given equation, resolving the autocorrelation problem, requires the delay for m-term. In this study, delay number (m) of variables taken to ADF test, is determined according to Akaike Information Criteria (AIC).

According to the Engle and Granger's presentation theory (Engle and Granger, 1987: 251-276), on condition of antistatic variables being integral at the same grade, if linear components form a stable period, it is said that these variables are cointegrated. According to this theory, the first condition in investigation of cointegration is investment that whether the variables are integrated at the same grade. Thus, Engle-Granger method is used for.

By this method, regression model is estimated and error terms are found. Afterwards ADF test is applied to these error terms found. If those error terms were found static, then it arrives at a conclusion that there is a long term relation among these series. With an another expression, it is deduced that those series move together; on the contrary, that those series aren't cointegrated, namely they don't share the same stocastic trend (Yamak and Küçükkale, 1997:9).

C. Results of Estimation

The first step in analysis is to investigate the integration grades of variables in number (1) inflation model. By this porpose, the results of ADF unit root test applied are given in tablo-1.

As seen in table, two of ADF τ (tau) statistics ones existed meaningful at the 10 % level of significance and others at 1%. Therefore, ADF unit root test results have shown that all of variables were cointegrated, namely I (0), at their original levels.

TABLE-1. ADF UNIT ROOT TEST RESULTS

| Variables | Without statical Term and Trend | With statical Term | With Statical Term and Trend |
|---------------------------|---------------------------------|--------------------------|------------------------------|
| Y_t | 6.9015 (6) ^a | 6.8950 (6) ^a | 7.1061 (6) ^a |
| X_{1t} | 3.9821 (0) ^a | 2.7984 (6) ^b | 3.2271 (0) ^b |
| X_{2t} | -3.6858 (0) ^a | -4.2197 (0) ^a | -5.8168 (0) ^a |
| X_{3t} | 7.6203 (6) ^a | 7.4767 (6) ^a | 7.1377 (6) ^a |
| MacKinnon Critical Values | | | |
| %1 | -2.6072 | -3.5598 | -4.1420 |
| %5 | -1.9470 | -2.9178 | -3.4969 |
| %10 | -1.6191 | -2.5964 | -3.1772 |

- Notes: 1. Being the values in the first parenthesis as delay numbers in ADF equations, are determined by using Akaike Information Criteria (AIC).
2. a is meaningful at 1% level of significance
3. b is meaningful at 10% level of significance

Because of whole variables are integrated at the same grade, the long-term cointegration relation can be tested. By this purpose, it is tried another method testing cointegration between the variables in number (1) equation. Thus, through applying Engle-Granger method, ADF τ statistic is found as

-1,9704 (3). And relevant MacKinnon critical value at 1%, 5% and 10% level of significance is, in turn, -2,6072, -1,9470 and -1,6191. At the 5% level of significance, because of ADF τ statistic is higher than MacKinnon critical values have put forward that there was a meaningful cointegration between the variables in inflation model.

When the cointegration vector which gives long-term inflation function is estimated through "Ordinary Least Squares Method", following results were obtained:

$$\begin{aligned}
 Y_t &= -9522,197 + 0,0239 X_{1t} + 0,0003 X_{2t} + 0,005 X_{3t} \quad (3) \\
 s : & (1848,100) \quad (0,034) \quad (0,0001) \quad (0,0004) \\
 t : & -5,152 \quad 6,925 \quad 2,856 \quad 11,601 \\
 p : & (0,000) \quad (0,000) \quad (0,006) \quad (0,000) \\
 n = 60 \quad R^2 &= 0,9324 \quad \bar{R}^2 = 0,9286 \quad F = 252,569
 \end{aligned}$$

These estimation results, both statistically and econometrically are meaningful according to econometric criterias, and verifies both of hypotheses which revealed in the study as well. Thus, both the increment in internal and external borrowings and the increments in payments of borrowing interests have increased the inflation during 1985-1999 in which we examined. Therefore, it has played a role demolishing the economic stability.

By estimation results, both parameters severally and being a model integral have been found meaningful. In addition, when R^2 value is taken into consideration, it is seen that approximately as a part of 93% of the variation in inflation rate is revealed by external, internal debts and debt interest redemption together.

It is known that the public deficits in Turkey, traditionally have been financed with external, internal and Central Bank's resources. Especially in case of using the internal borrowing as a weighted financial instrument, does the real interest rate increase up and this causes inflationist pressure (Sönmez, 1998:62).

As known, when government finances the public expenditures applying to internal borrowing (issuing of treasury bonds and bills, short term advance from Central Bank and so on) reduces the interest rates in short term; this situation causes economics of production to be decreased and evaluation of funds which can be transferred to investments, into economics of rent of which has no any contribution to national income and significantly increases the costs of credit use of entrepreneurs. Briefly, application of government to internal borrowing, leads to negative results on economics of production. In long term, the issue of the tax burden of next generations come to order. In this respect, the over internal borrowing has been fairly a disadvantageous fiscal policy in respect of real economy (Aktan, 1996:25).

Therefore, in the factors which support inflation rate, it is possible to mention about the disparities of income-expenditure, budget deficits, over growing of expenditures in which especially being high transfer expenditures and debt interest payments inside it.

It has been appeared that following fiscal policies were successful in the direction of have increase the export, however because of the export is mostly based on import, an increase in export caused to import to rise and thus it hasn't an affirmative effect on reducing the trade deficit. Furthermore, being parallel with private sector investments to decrease, the share of investment goods import in total import have been declined. From all these issues, it can be state that the following fiscal policy was unable to obtain a structural changing which would carry on the export growing and decrease its import dependence (Savaş, 1997: 10).

Ongoing analyses have shown that the fiscal policies oriented to internal and external borrowing and debt interest payments couldn't obtain the economic stability in Turkey during 1985-1999; with another statement, those following fiscal policies for inflation fighting weren't successful.

IV. General Conclusion

Recently, Turkish economy has been enrolled with the effect of hard money policy based on high interest rate-low exchange policy and rent economics consists of a high-coupon stocks and bond borrowing.

The high level of debt interests, elasticity of budget and fiscal policies have largely been decreased and failed the economy policies concerning to obtain economic stability and budget equilibrium.

By these data whose we have used in this study, as to the results of period of 1985-1999 that we have examined;

- Following fiscal policy instruments have generally been consist of the taxes, expenditures, borrowings, State Economic Enterprises' prices and funds.

- Fiscal policy has been contractionary used for to reduce the public investment expenditures in real terms during 1985-1999.

- The biggest share in public sector borrowing requeriments, has been belonged to consolidated budget, together with transfer expenditures and internal and external debts and interest payments inside it, earthquake disasters have affected the growing of budget expenditures as well.

- It has been revealed that the investment expenditures were continually decreased, on the contrary, the current especially transfer expenditures were increased.

- The ratio of consolidated budget expenditures with GNP has been continually increased and the reason of this increasment has been the debt interest payments.

- It is seen that the following piscal policies, especially the tax-oriented export promotions' measurements were in favour of the export; however because of the dependence on import, the import was increased as well and it hasn't shown the continuity in reducing the foreign trade deficit.

- In expenditures, the personell expenditures especially debt interest rates have been currently increased, recently debt interest has reached to 70% of the tax revenue

- We have seen that in financing of liquidity deficit, the external borrowing wasn't applied, on the contrary the internal borrowing was prefered, recently short term borrowing (bound weighted) was used.

- During 1985-1999, in borrowing where the bond and advance were in the forefront, it is ocured that the banks had big resources and lending to public was accepted by the banks.

- In the budgets of 1996 and 1997, although it had been stated that in the financing of public deficits, the obligation financing would be increased and short term financing resources would be decreased; the public sector was mostly applied to short term borrowing in 1996 too. In spite of partially returning to long term internal borrowing in 1997, the short term internal borrowing again has pull ahead of long term borrowing in 1998.

- In 1999, long term internal borrowing (obligation) had been prefered. In recent months, forward borrowings over a year had been applied.

- However, at the end of examining the nature of bond date which is used for as a borrowing instrument, recently (except the last terms of the end of 1999), it is understood that in general long term bonds (a year and below) were mostly prefered. Whereas it is a well-known fact that the shortness of internal debt and its interests term were an important factor at the point of inflation rising and affected the economy negatively in short term.

Related to the crisis, it is seen that following contractionary fiscal policies in 1994 and early 1995s were left at the end of 1995 and in 1996. In addition, in 1997 and 1998 governments had carried out the expansionary fiscal policies. In 1999 and 2000, serious some policies and measures concerning to reduce the inflation rate are on the agenda.

The important issue is that ; recently the budget without interest and fiscal policies applications have been contractionary affecting the total demand; but fiscal policy has been showing an expansionary effect because of internal and external debt burden and high interest expenditures.

The main purpose regarding to inflation fighting in fiscal policy is to increase the ratio of primary surplus in GNP.

Contrary to targeting contractionary fiscal policies, in practise its entering into an expansionist trend caused to forming an unstable growing structure domestic demand-based and a chronic inflation to form. Thus;

In our econometric study too, it is suggested that the fiscal policies regarding to internal and external borrowing and interest payments were unable to obtain economic stability and they have increased the inflation.

In conclusion, by purposing to prevent the chronic inflation during 1985-1999, while it was required to reduce the public expenditures, to increase the revenues, to attach importance the contractionary fiscal policies to decrease the monetaral expansion or borrowing use for financing to income and expenditure difference; on the contrary, in practise it has been seen that those aims above were unable to achieve, both expenditures and deficits weren't collected and recently progressive short term borrowing and Central bank sources were used; that case shows that over internal borrowing and especially its term structure, as a fiscal policy tool, needs to be refrain for our economy; the view of tax, expenditure, borrowing and budget policies claim that the fiscal policy is not effectively used for economic stability.

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TOWARDS A SUSTAINABLE TOURISM MANAGEMENT IN MALAYSIA

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Abstract

Tourism industry is a key foreign exchange earner for Malaysia, contributing to over 40% of the country's balance of payment in 2005 (EPU, 2006). The industry provides an important source of income, employment and wealth to the country. Thus, there is a need to ensure that the tourism industry remains both environmentally and economically sustainable. However massive influx of tourists can also cause a detrimental environmental impact. Industry players and improper strategies in attracting more tourists could also add further destruction to the environment. Protection of the environment is vital in ensuring the sustainability of the industry. Hence, the purpose of this paper is to discuss the issues pertaining to sustainable tourism development in Malaysia. In so doing, policies, regulations and strategies to achieve sustainable tourism will be examined. The paper concludes with the arguments for having local agenda for sustainable tourism in Malaysia.

Keywords: Environmental policy, Local Agenda 21, Malaysia, Sustainable tourism, Tourism policy

INTRODUCTION

Tourism industry, a major contributor to the world economy, is continually growing at 4 to 4.5% annually (UNEP 2003). It has generated an estimated gross output of US\$3.5 trillion and employing 207 million people in 2001 and expected to increase to US\$7.0 trillion of gross output and employing 260 million by 2011 (World Travel and Tourism Council, 2006). The tourism industry contributed to economic development through among others, providing employment and business opportunities, infrastructure improvement and increased in foreign exchange and tax revenues.

Even though Malaysia is a relatively new entrant into tourism activities as compared to its ASEAN neighbours, the industry has grown tremendously over the years. By 2005, tourism industry is a key foreign exchange earner for Malaysia, contributing to over 40% of the country's balance of payment (EPU, 2006). The industry has provides an important source of income, employment and wealth to the country.

However, a massive influx of tourists can also cause adverse environmental impact due to increase in consumption of natural resources, consumerism and waste generation. An unsustainable tourism could lead increase in solid waste, degradation of heritage and cultural sites, reduction in biological diversity, destruction of wildlife and subsequently leads to river, lakes and sea pollution (APEC, 2002). Thus, it is not surprising that a palaeontologist has argued that tourist should watched nature on TV instead of going into areas of great biological important that cannot sustain large number of people (as quoted in Edmonds and Leposky, 1998).

Given the significant role of tourism in the economy and the potential benefits from it, there is a need to ensure that the tourism industry remains both environmentally and economically sustainable. In ensuring the sustainability of the industry, protection of the environment is of foremost importance. Furthermore, sustainable tourism development has

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become an important criterion in attracting tourists. For example, Miller (2003) in his research interviews with tourism consumers at a Destination Travel Show, found that environmental considerations is one factor used by customers in choosing tourism product as he explained below:

“Consumer are already making decision based on environmental, social, economic quality for day-to-day products and are keen to transfer these habits to the purchase of the tourism products” (Miller, 2003).

In view of the adverse impact of the environmental and cultural degradation on tourism products, the Ministry of Culture, Arts and Tourism has formulated The Malaysian National Ecotourism Plan to ensure conservation of Malaysia's natural and cultural heritage. It also aims to maximize the economic, socio-cultural and environmental benefits that can be gained from the tourism sector. Hence, the purpose of this paper is to discuss the issues pertaining to sustainable tourism development in Malaysia. In so doing, the governmental tourism and environmental management policy, regulations and guidelines will be examined. The implementation of Local agenda 21 is also explained in the paper together with the problems of coordination and issues constraining sustainable tourism industry in Malaysia.

SUSTAINABLE TOURISM IN MALAYSIA

A poorly planned and managed tourism development, besides being detrimental to the environment and the local communities, could result in decrease in market share (APEC, 1996). As a result, a more sustainable tourism development is needed. Sustainable tourism development has three inter-related major components, i.e., the environmental, economic and social cultural. It is defined by UNEP (2001) as follows:

“Sustainable tourism development meets the needs of the present tourist and host regions while protecting and enhancing the opportunity for the future. It is envisaged as leading to management of all resources in such a way that economic, social and aesthetic need can be fulfilled, while maintaining cultural integrity, essential ecological processes, biological diversity and life support systems”, (WTO)(UNEP,2001)

Besides ensuring the preservation of the environment, tourism activities should preserve the culture of the local communities and provide adequate economic opportunities for the locals whilst guarding them against exploitation (Moore 1996, Leposky 1997). A sustainable tourism development should:

- (i) optimise the use of environmental resources while preserving the natural heritage and biodiversity
- (ii) respect the local culture of the host community through conserving the living cultural heritage
- (iii) ensure sustainable and equitable economic operations and employment opportunities and social services to local community while contributing to poverty alleviation.

(UNEP, website)

Due to nature of the tourism industry, a sustainable tourism development should be based on coordinated actions between the different sectors involved (APEC, 2002). Constant monitoring of the impact of tourism is needed together with the use of preventive and

corrective measures (UNEP, website). Integrated and meaningful multi-stakeholders participations from a broad spectrum of the host communities are needed. The partnership should be at the federal, states and local level and should be back by strong political leadership.

The role of the Malaysian government in promoting sustainable tourism is evident in the existing legal and institutional framework. There is evidence that indicate that Agenda 21 have been adopted in the national master plan. To speed up the development of tourism industry, the Malaysian Tourism Policy was formulated in 1992. The policy had identified ecotourism as one form of tourism to be expanded and sustained. It was followed by a more specific national ecotourism plan three years later. The National Ecotourism Master Plan was drafted in 1995 and was accepted by the government in 1996.

The national ecotourism plan was intended to provide a general framework to assist the government in developing the country's ecotourism potential. Under the plan, the definition of ecotourism follows that of the International Union for the Conservation of Nature (IUCN). Ecotourism is defined as responsible travel and visitation to relatively undisturbed natural areas in order to enjoy and appreciate nature that conserves the environment and sustains the well-being of local people. As a result, quite a number of the tourism destinations in Malaysia as been gazetted terrestrial or marine protected areas in various categories such as forest reserves, wildlife reserves, sanctuaries, wetlands and marine parks.

In order to ensure the success of the eco-tourism plans, joint efforts between the various levels of government, the private sector and the local communities were planned and carried out to maximize the economic, socio-cultural and environmental benefits it has to bring. Although MOCAT (Ministry of Culture, Arts and Tourism) acts as a single coordinating body to spearhead the overall implementation of the National Eco tourism plan, the Ministry recognizes the imperative role of the private sector and specifies roles for all sectors of Federal, State and Local Authority (LA), private business, NGOs and other players, (APEC, 2002).

Under the 9th Malaysia a more integrated approach to tourism planning and management are to be undertaken (EPU, 2005) through preserving as well as enhancing the existing and natural and cultural assets. In addition, the role of the State Tourism Action Councils (STAC) will be further expanded to include regular monitoring and evaluating of project outcomes. At the local level, local authorities and communities are encouraged to have a more active role from the beginning of the projects so as to minimise environmental destruction. For businesses, such as hotels and resorts, they "will need to incorporate, among others, water and energy conservation as well as waste disposal aspects in the implementation, management and maintenance plans" (EPU, 2005, pg 201). More emphasis will be given to the preservation of the natural attractions to enhance eco-tourism as well as preservation of the heritage tourism such as historical sites, buildings and artefacts that are categorized under preservation of the natural attractions. In addition, more value added activities are incorporated in the agro-tourisms and home stay programmes (EPU, 2005)

There are the arguments that sustainable tourism should not be left to market mechanism and industry self regulation but should be backed with policies and legislations. Thus, sustainable tourism needs to be backed by environmental policy and legislation.

MALAYSIA ENVIRONMENTAL POLICY AND LEGISLATION

As earlier mentioned, tourism industry could lead to negative impact both to the environment and local population if not monitored. Malaysia is one of the 12 mega-diverse countries in the world that accepts the importance of preserving its social, environmental and cultural wealth heritage. Given that Malaysia is banking on the natural environment for the

tourism attraction, various actions have been taken by Malaysian government to protect the environment.

The first initiative of environmental management in Malaysia commenced formally in 1974 when a regulatory agency known as the Department of Environmental (DOE) was set up. It was during the 1980s, in tandem with the global trend attributed primarily to the alarming scientific findings on environmental degradation, that DOE function was seen as important (Mohammad, 2002). Later environmental issues dominated discussions in many international forums and among the salient outcomes of such discussions were the Langkawi Declaration on Environmental and development at the Commonwealth Heads of Government Meeting (CHOGM) in 1989, the Bio-diversity Conversation during the United Nations Conference on Environment and Development (UNCED) meeting held in Rio de Janeiro, Brazil in 1992 and the Montreal Protocol on the reduction of non-essential chlorofluorocarbon (CFC) usage (Mohammad, 2002). Among the noticeable action is the environmental awareness campaigns carried out by the DOE and other relevant agencies as well as active participation of the non-governmental organizations.

Locating specific legislation that discuss about sustainable tourism might be frustrating. Nevertheless there are many policies and acts which were formulated by the Malaysian government that are favoured to the environmental issues. Among others are the Environmental Quality Order, 1987; National Parks Act, 1980; The Protection of Wildlife Act of 1972, The Fisheries Act, 1985; The National Forestry Act, 1984 and the establishment of Marine Parks Malaysia Order of 1994. Each of these policies falls under different jurisdiction of the government authorities which might impede smooth implementation of sustainable tourism due the bureaucratic obstacles.

Acknowledging the need to have a more holistic guide, the Malaysian government has come out with the Malaysian National Conservation Strategy (NCS):

The intention of the NCS is to set out plans and suggestions which can be used to integrate more fully the many existing efforts toward natural resources management for conversation and development, to build on the strength of existing institutions and mechanisms, and to incorporate additional future efforts into the process of conservation as a key to successful and sustainable development

(Mohd Nawayai 2008, pg 70).

The strategies outlined by the NCS seemed to have close similarity with what are prescribed in the Agenda 21 toward achieving sustainable tourism. This evidence lends strong support for the implementation of Agenda 21 in the national policy. This implies that the Malaysian government is serious in making their way toward achieving sustainable tourism.

LOCAL AGENDA 21

In the context of eco-tourism, local authority, which comprises the City Hall, the municipalities and district councils are the main players in the implementation stage of sustainable tourism development agenda. They are also responsible in providing proper maintenance as the tourism destinations fall under their area of jurisdiction. Chapter 28 of Agenda 21 clearly binds them to take lead in the implementation of the sustainable development at a local level. It is an approach through which a local community defines their strategy and the action program to be implemented. The whole process of the

implementation of Agenda 21 can be summarized into three components of strategy and action plan. The three components are as follows:

- *Establishing effective structures for multi-stakeholder participation, both in setting the direction for tourism in the community and in working together to develop and manage it.*
- *Identifying a strategy for sustainable tourism within the context of a wider sustainable development strategy that reflects stakeholders views and that allows tourism management to integrated with other management functions in the destination.*
- *Identifying and implementing a set of actions, in line with the strategy, that address the economic, social and environmental sustainability of tourism in the area.*

(Cited from Tourism and local agenda 21, UNEP, 2003)

Each of the above strategies will be further elaborated in the following paragraphs. The first component discusses about setting up effective structures for multi stakeholder participation. Effective multi stakeholder structure needs direction and leadership and local authorities are usually well placed to provide the leadership (UNEP, 2003).

The local authority is expected to coordinate and facilitate the participation processes. This includes providing training to the various stakeholders involved. As the process touches so many aspects of society, and cuts across wide range of local authority functions, it may require high level of political engagement. This will help effective coordination across department as well as various interests are safeguarded. At this participatory stage, commitments from the various stakeholders are crucial. This will involve customers, local community, tourist agents, small retailers and various departments in the local authority. Their initiative and contribution will definitely make a difference to the whole participatory process.

The second component touches on the sustainable tourism strategies and the local management tools. It is important to ensure that sustainable tourism is integrated within the overall policies and actions towards sustainable development in the area. The process involves using the stakeholder groups to identify issues, agree on an overall vision, identify strategic priorities and establish an action programme. Other issues that may not be directly related should also be considered in formulating the strategies. The strategy should be based on sound analysis and specifically address the economic, social and environmental impacts of tourism. This is different compared to the traditional practices which focus only on the economic impact. In order to ensure the vision is translated into reality, it requires setting goals, targets, indicators and monitoring procedures.

The last component is on the identification and implementation of a set of actions which is in line with the strategy that addresses the economic, social and environmental sustainability of tourism in the area. The actions taken should benefit all three and are mutually reinforcing rather than discrete actions. Listed below are actions proposed by UNEP (2003).

1. Improve environmental planning and management in the destination
2. Promote more sustainable transport
3. Conserve and promote natural and cultural heritage resources
4. Help tourism enterprise to be more sustainable
5. Use appropriate certification schemes
6. Promote the use of local product and integration with other sectors
7. Strengthen communication with the visitors and local residents

Malaysia as one of the signatories of the Agenda 21 is therefore expected to oblige with the concept of sustainable development. Thus, Local Agenda 21 was implemented by

four local authorities in 2000. They are the Miri City Council, Petaling Jaya City Council, Kerian District Council and Kuantan Municipal Council (Awang Kipli, 2006).

LA 21 committees, comprising members from the civil society; local authority and business community, were formed. Their functions are to develop action plan and raised awareness on sustainable development issues, promote cooperation between stakeholders, and establish and monitor sustainable development indicators (MHLG website). By 2005, LA 21 was implemented in 47 local authorities in Malaysia. Sixteen of them launched action plan for sustainable development covering social, environmental and economic issues. The LA 21 will be implemented in all local authorities during the 9th Malaysian Plan period (EPU, 2006).

However, the LA 21 initial projects are not focusing on the issue of tourism specifically but instead on other environmental issues such as solid waste management that is considered as critical in the country. Although having clean cities can help promote tourism locations, unless the local authority can identify and promote attractive locations, the impact to the tourism industry can be minimal. For example, the LA21 programme in Miri City Council mainly relates to waste management system, pollution of river and public places and better drainage network (Awang Kipli, 2006). The activities undertaken did not have a significant impact on waste reduction but it has created awareness and education on waste reduction activities among the community (Awang Kipli, 2006).

Similarly, LA 21 activities in Kota Kinabalu mainly relates to waste reduction and creating awareness on environmental issues (see DBKK website). The implementation of LA 21 in Petaling Jaya clearly illustrated that the local concern rests mainly with daily issues faced by residents such as crime, vandalism, safety and service delivery. The same is true for Kerian Municipal Council. The LA 21 activities for that local authority cover areas related flood and drainage irrigation system, environmental pollution, road and traffic, community facilities and social problems and poverty and housing.

Even in cases when the citizens and local community are concern about sustainable development, the long term political commitment left much to be desired as happened in the case of Penang island. Penang is one of the major tourist attractions in Malaysia. Tourists have been flocking to Penang for its sea, sun and shopping expeditions. However, rapid development in the island has been detrimental to environment and has led to multitude of problems such as air, water and coastal pollution, loss of natural eco-system, traffic congestion and so on (Nasution, 2002). Thus, there were calls made to have a more balanced development to the extent that Sahabat Alam Malaysia, an NGO, had called for the banning of all hill development in the island (Buang, 2005).

Sustainable Penang Initiative (SPI) was launched with the purpose of ensuring a more balance and holistic development in Penang with consultative partnership with the government, the business community and civil society (Nasution, 2002). The outputs from the consultation process were to be channelled to the relevant authorities as an input in their development planning (Nasution, 2002). However, there is not much political commitment to the SPI. For example, the cutting and hill clearing along the famous Tanjung Bungah Batu Feringgi tourist belt to be used especially for high end housing development are left unchecked. This is contrary to the spirit of SPI. The whole system made a mockery of LA 21.

Another example is the case of coastal land reclamation project in Tanjung Tokong. The land is to be used for high end housing projects and will subsequently lead to the gentrification of the area. Sustainable development and public participation is just lip service. The loss of beach to the population and the long term ecological damage were not considered in the development plan. This is also reflects the short term orientation of the relevant parties. The sea, sun and sand tourism are the attractions of tourists to Penang. The

sea pollution, traffic congestion and a host of other issue have lead to loss of Penang competitive advantage to the tourism consumers. Thus, the participatory approach as in the case of SPI does not lead to real effective input the development planning process.

Even though environmental laws and policies are put in place, sometimes there are no real enforcements. During the EAI process, feedback and input from the public affected by the project are needed. But, public participation is not really emphasised since EIA can be submitted and approve even without the community affected by the project knowing about it (Kwong, 1996). Even when the local authority did not give planning permission for hillside development, it could be overturned as in the case of development in Paya Terubung, a hill land in Penang. The developer has managed to de-gazette the hill land. When the developer appeal to Penang's Appeal Board against the local council withholding of the planning permission, the Board stand is that planning permission should be given since the land now is not officially considered as a hill land (Buang, 2005).

Beside the lack of political commitment, another constraints faced in sustainable tourism development is due to the lack of trained and skills personnel together with the lack of financial resources both at the state and local level to maintain tourism products, facilities and infrastructures. Thus, even though Malaysia has incorporated sustainable tourism principles into her tourism master plan, the diffusion of such philosophy to the local level has been quite slow (Cruz, 2003). There is dire need to introduce and effectively implement local agenda 21 for sustainable tourism to ensure more responsible tourism practices. Tourism should be integrated in with the overall policies and the strategies and there should political commitment to implement the strategies and enforce the policies and regulations. There is a need to have a local agenda for sustainable tourism put in place in Malaysia

THE NEED FOR LOCAL AGENDA FOR SUSTAINABLE TOURISM

Any policy that is developed will be carried out by government agencies located at both federal and states as the arms to implement it. In many cases, it is the LA that is given the responsibility to see that the policy implementation is carried through. Unless the LA is serious, committed and have specific directions on how to go about implementing the policy, success cannot be associated with. In Malaysia, land use is considered a state matter and therefore comes under the purview of respective state governments. In this context, each state government is directly involved in developing and promoting land-based tourism. Tourism product is unique in the sense that customers have to come to the particular location in order enjoy it (in marketing, this is known as the 'pull' strategy).

Due to this uniqueness, the state and local authorities must play significant role in formulating, organizing and coordinating the appropriate policy to ensure the tourism they develop and promote is saleable. The implementation of tourism development in general or the ecotourism development in particular can be seen to vary within the different states in terms of focus and speed of implementation. For instance, Perak state has been lagging behind other states such as Selangor, Wilayah Persekutuan and Penang in competing for tourism market in Malaysia due to its perception that tourism is secondary to commodities. Perak state's economy has been highly dependent on its commodities such as tin, rubber and palm oil (Mohd. Zuhri, 2003). It was only in the 1980s that it started to put priority in developing the state's tourism industry. Even then, it took a few more years to see the state to identify its ten tourism products that emphasized on the state's ecotourism, culture and natural heritage.

Although the state has realised its mistake and has since worked to rectify it, implementation wise, it has a lot to answer for. For example, when Perak State Tourism Action Council developed its strategic action plan to develop tourism industry for the state,

Taiping is promoted as the heritage city of Perak and is listed as one of the ten attractions for tourists. As argued by Abdul Wahid et al. (2007), the declaration of Taiping as a heritage town by the State Tourism Action Council (STAC) is “insignificant unless the state or municipal is serious at promoting it as such. The status given via ‘heritage’ should be respected and acted upon fittingly”.

The reason is due to the placement of a landfill within the area of tourist interests in Larut-Matang. One of the heritage attraction of this place is the Makam Dato’ Sagor, a grave belonged to a famous Malay warrior who was hanged in 1871 as he was accused as one of the mastermind in the assassination of J.W.W. Birch, the first British Resident in Perak. His grave unfortunately is located just 100 meters from Larut-Matang landfill. Not too far away is another famous location i.e. Kota Ngah Ibrahim, the residence of Ngah Ibrahim as Menteri Larut that also act as the court that deliberated on the fate of Dato’ Sagor’s and two more of his accomplices. The common complaints associated with the landfills from local residents are: bad smells especially during rainy and windy days, the increase number of flies, dusts and other waste residues that fall from the vehicles carrying waste to the landfill, noise from the vehicles, etc. (Abdul Wahid et al, 2006).

The Wahid et al. (2007) study showed that the complaints do not come only from local residents but tourists as well. The discomfort can be experienced from as far as Matang Historical Complex which is 1km away from the landfill. Unfortunately, although this is the case, actions to help ease or solve the problem have not been taken up by anyone. The local community and LA like Majlis Perbandaran Taiping (MPT) should work together to solve this problem

Thus, the suggestion to use an integrated approach to tourism planning and implementation with emphasis and preserving existing natural and cultural assets as had been outlined in the 9th Malaysian Plan to be closely followed. Proper act and support by both local authorities and communities can ensure the Malaysian tourism industry remains both economically and environmentally sustainable, in particular for Taiping town itself (Abdul Wahid et al., 2007).

The state and local authorities should take genuine interest in places like Tasik Chini and Royal Belum that possess special characteristics like: conscientious, low-impact visitor behavior; sensitivity towards, and appreciation of, local cultures and biodiversity; support for local conservation efforts; sustainable benefits to local communities; local participation in decision-making and educational components for both the traveler and local communities. It is very important to understand what characterizes an ecotourism that will separate it from the other types of tourism, i.e. heritage, rural, extreme sport, health, etc. and to continue promoting it as such. This is because today, ecotourism has become a ‘buzz’ word in tourism development because it is believed to be a rapidly expanding sector of the tourism industry (Tisdell, 1988; House, 1996). This is due to an increase of variety of existing market segments due to increased tourists’ education background, awareness of environmental issues, different life styles and taste, etc.

Furthermore, the growing number of eco tourists has inspired most conservation groups to see ecotourism as a brand new solution to achieve ecologically sustainable development. Tasik Chini for instance boasts having a navigation lockgate that functions not only to maintain the water level of the lake so that people can navigate their boats easily in both wet and dry seasons (for both sight seeing and other water related activities) but also to fix the water level to minimize bank erosion (Abustan et al., 2002). Abustan, et al. (2007) study had identified both its scenery and water quality as the main attractions that pull tourists to the lake. The problem the lake is currently facing i.e. aquatic weeds, colour and water turbidity, and litter must be solved together by the stakeholders. It is not enough to let the LA

alone to do the job. But the community will not be able to help out unless they are given support by the LA.

It is still quite unfortunate to find that although many environment stakeholders such as the governments, ministries of education, school districts, and educators in Malaysia are interested in promoting sustainable tourism in the country, many of them are working individually instead of together. Not having a model of Local Agenda for Sustainable Tourism (LAST) that can be applied or replicated within the traditional environment setting makes the decision of how to implement it a problem. Without a model of which the community can adapt and/or adopt, they are left with the task of having to define what sustainable ecotourism is with respect to their local context (e.g. according to traditions, culture, etc.).

The local authorities need to play active part in setting vision, mission of sustainable tourism in particular the ecotourism itself. The community should be informed and invited to play an active role in maintaining control of tourism development that they want for the community at all stages of the implementation. The community should have local ownership of the product they are offering. Sustainable tourism development is only considered successful if and when the tourism is able to provide quality employment to its community. It should be a win-win situation for all i.e. it should sustain the well being of the local people, supports efforts to conserve the environment, and contributes to biodiversity.

The local authorities along with the community must establish a code of practice to follow (includes guidelines for tourism operations, impact assessment – i.e. to minimize environmental impacts using benchmarks, monitoring of cumulative impacts and limits to acceptable change that is to take place due to the tourism activities). A Local Agenda for Sustainable Tourism (LAST) Model should be developed. LAST model must possess the following characteristics:

- (i) must be locally relevant and culturally appropriate, reflecting the environmental, economic, and social conditions of the community in question.
- (ii) created through a process of public participation in which stakeholders from across the community can express their visions for a sustainable community and their choice of the type of ecotourism orientation to address sustainability should include.
- (iii) every stakeholder can contribute to LAST according to the strengths of the model.
- (iv) communities and local government systems should work together to achieve community sustainability goals.

LAST can be an important "bottom-up" driver of community-based sustainable development through the shaping and encouraging of behaviors and ethics supporting an informed, knowledgeable citizenry with political will to achieve a sustainable future.

The stakeholders like the government, the industries and the society should be encouraged to take part in leading the sustainable tourism. While appropriate ministries can jointly help in developing suitable policies, other stakeholders can take part in supporting the push and lobbying of the policies apart from trying to help organise sustainable tourism related programs themselves, finding partners to organise the programs or sponsoring the events. Bringing the programs to local councils, NGOs, schools or other learning institutions and the industries will be one good way of how this can happen. Conducting the 'Training the Trainers' programs for administrators, teachers, etc. who act as role models and opinion leaders in society is also essential to be carried out continuously. Different issues emerge everyday with different solutions to provide. Trainers need to be well equipped with knowledge and means to understand the issues:

What – What sustainable tourism program should we promote?, What will be the focus of the program?, What do we get out of this?, etc.

Who - Who should start the program?, Who are the targets?, Who should sponsor?, etc.

Why – Why we choose this program, not others?, Why those targets, not other segments?, etc.
When – When do we start (now, yesterday, tomorrow)?, etc.
Where – Where to start (geographic location, type of organisation, etc.)?, etc.
How – How do we go about doing this?, etc.

CONCLUDING REMARKS

For the tourism sector to be sustainable, strategy to achieve it need to be integrated with the wider strategy sustainable development strategy with effective multi-stakeholder participation. Moreover, actions in line with the strategy should be implemented. Besides effective participation from the various stakeholders, the tourism strategy should be integrated with the wider strategy for sustainable development. The tourism management should be integrated with other management functions and actions in line with the strategy should be implemented

The success of achieving sustainable tourism depends very much on how we define each issue, their scope and seriousness and the full support and commitment from all stakeholders. The planning design of sustainable tourism must be made and presented at every level, especially the national level to ensure consistent understanding of the concept. By brainstorming the idea of sustainable tourism (program-, policy- and practice- wise), the local community needs will be identified and thus, can be properly addressed.

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ORGANIZATIONAL LEARNING: KEEPING IN THE LEARNING LOOP BY MANAGING MANAGEMENT KNOWLEDGE

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Abstract

This paper will explore the significance of managing management knowledge within the organization and to reflect upon the existing trends in managing such knowledge. This will also discuss how the culture of learning impacts business decisions and supports management objectives.

The discussion in the paper provides an insight on how management knowledge is crucial in making pertinent business decisions. It also emphasizes the importance of dissemination of such knowledge across organization through a suitable culture of perennial learning and knowledge-sharing to enable the organizations to remain competitive and emerge as learning organizations.

It would be useful for a practicing manager to get an insight into the relevance of managing management knowledge, and how this can be institutionalized to meet business demands through continuous learning and what strategies could be used to leverage upon such knowledge.

Field of this concept paper: Management, Knowledge Management, Organizational Development

1. Introduction

The unequivocal organizational need to learn is embedded in the amazing volatility of the business environment and an unprecedented technological metamorphosis which compels every company to maneuver its learning curve to keep in the groove and continue to perform. A comprehensive repertory of skills, knowledge, abilities, attitudes, values and beliefs enables an organization to transact its business and to direct its efforts towards achieving the super-ordinate objectives of the organization. Knowledge may assume other dimensions as well such as news, concepts and ideas which may enable business problem-solving (Sahlin-Andersson and Engwall, 2002) and rationalization of organizational tasks that managers have to take up. Management knowledge often undergoes faddish phases and this implies an entire trajectory of concurrent thoughts, ideas and best practices which might influence the way managers think globally. This dispersed body of knowledge does into lend itself to easy management within an organization until and unless the organization has been able to capture these disparate pockets of knowledge through frequently changing fashion of management thought. Sometime the idea of yesterday may come back today in a more refined shape.

2. Literature Review

Right from the time of reinventing the management thought, it has been pertinent for organizations to use currently available trends in doing business. From the hey day of Scientific Management and Hawthorne Experiments to Business Process Reengineering and Six Sigma, it has been extremely fruitful for corporate organizations to internalize the available business knowledge for greater value. These predominant trends may often sweep across industries and may compel the managers to reorganize their heuristic decisions to adapt to more currently validated way of doing business. Right from start-ups to well established business empires, these concurrent sources of knowledge are very well adapted to the

challenges of that specific time in a particular industry and captures the vicissitudes of business activity at a given point in time. Because of a high contemporary relevance, these fads in knowledge are regarded with great expectation and have often lived up to those. Be it Frederick Taylor's Therbligs, which initiated the time and motion studies and enabled manufacturing industries to benefit from precision of work-place behavior or be it the quality fetish of Six Sigma driving the business engine to minimize errors, these novel ideas of the time have helped streamline processes and systems to boost the revenue curves. It would be therefore only naïve to ignore the need for capturing such an enriched and relevant form of knowledge. When the industrial revolution commenced, Taylor's engineering perspective crystallized in the principles of scientific management helped many businesses shape their initiatives in a more systematic fashion avoiding the ad hocism which prevailed at that time. Management of means of production and controlling the efforts of the people responsible for production was imperative. But how to channelize this effort meaningfully was the task of thinkers such as Frederick Taylor, whose pioneering ideas facilitated the transition on the shop-floor. A Peter Drucker or a C K Prahalad would do a similar thing a century later.

The importance of knowledge cannot be ever underestimated but in recent times more than at any other, knowledge has become a common currency in business decision-making and with the "knowledge economy" and the information age (Drucker 1993; Reich 1991), the technological impetus has led to the value-creation in business domains through management knowledge and its myriad forms of utilization. Management knowledge and ideas are particularly gaining popularity in the knowledge economy and there is a spurt of experts pedaling the same. However for any business organization it means that there has to be a constant filtration of what is wanted and what is not and only the applicable concepts or information should enter the organizational "knowledgeware". In order to leverage from organizational competencies, the organizational effort should be geared towards using knowledge in a strategically effective manner so that it keeps the organization ahead of its competition and helps overcome complex business demands and challenges.

In a world predominantly dominated by media and technology, it is fascinating to observe that knowledge itself has acquired a highly ephemeral state and has become so dynamic that capturing it forever in a certain form eludes all probability. New thinking is emerging each day at a phenomenal speed, this means that organizational crucibles of knowledge, particularly that which is responsible for managerial decision-making will have to follow the "fountain-head effect". This implies that at its origin any form of knowledge that is acquired will have to be fluid enough to flow down and out of the organization when it is no longer needed to satisfy the organizational needs. New influences and management thought when it becomes available will have to be imbibed immediately and then this will have to also find suitable exit out of the organization whenever the management needs a more functionally valid and worthy idea, concept or thought. The skepticism that knowledge cannot outlive the use of it obviously holds true for any body of knowledge, including management knowledge. Scientific Management itself has traversed the path and evolved as Ergonomics and does not merely remain a mechanical contraption to measure the body movements of workers. Reinventing a new body of knowledge from the old source confirms that the "fountain-head effect" may just about help organizations remain in the learning loop with greater flexibility and boost the efficiency of managerial processes and systems. Upon scanning the existing literature on knowledge management, it is significant to observe that right from Peter Senge to T. A. Judge, great emphasis is being placed on the acquisition and dissemination of organization-specific knowledge and of course also on keeping the learning within the organization contemporaneous and perennial.

In an article entitled "What is knowledge Management?" Rebecca O. Barclay Managing Editor, & Philip C. Murray, Editor-in-Chief, *Knowledge Praxis* defines knowledge

management as a business activity with two basic attributes, which emphasize the focus of organizational knowledge management:

- “- Treating the knowledge component of business activities as an explicit concern of business reflected in strategy, policy, and practice at all levels of the organization.
- Making a direct connection between an organization’s intellectual assets — both explicit [recorded] and tacit [personal know-how] — and positive business results.”

As mentioned above, if the role of knowledge in management of business is to support the strategy, policy and practice of the organization and to establish a co-relation between the intellectual capital and the business efficiency, then it would be imperative for any organization to absorb the most recent developments in any given domain of knowledge and to seek its systematic renewal to enhance its utility value.

3. Strategies to manage Management Knowledge

The strategies to do this may encompass a host of initiatives such as learning from best practices to benchmarking. It may be feasible for any organization to use the one that basically suit their kind of business, once they have been able to detect the key variables that lead to obsolescence of knowledge in a particular industry. Keeping in the loop here will depend upon the kind of enrichment needed in the knowledge sources as applicable to specific area of business activity. For instance, obsolescence of knowledge in a pharmaceutical company may happen due to the advancement in medical research or superior R& D efforts. This may mean that environment scanning may be a useful strategy for organizations who wish to keep abreast of developments in their respective niche areas. Industry-based sources of knowledge may be extremely helpful to such companies and managerial competence may grow ten-fold if these sources are tapped in time to impact the operational decisions.

On the other hand, companies which are service-based such as banks, they may benefit from the best practices of other organizations. As the change in the knowledge pertaining to operations of this kind of industry is limited but there is phenomenal need to refashion the external information sources and use these for internal efficiency. In global information explosion this may mean that companies will have learn from one another to imbibe the most efficient way of doing things. Here companies which are industry leaders will be looked upon as a source of knowledge for best practices to guide management efforts and to influence business decisions. For instance, ever since HP has taken over IBM as a top IT vendor, obviously those seeking to use best practices in this industry will now have to find out why HP clicks. With its internal IT restructuring, HP has seen a simultaneous reduction in overhead costs, an increase in productivity, gains in profit and a rise in revenue. These indicators are a testimonial to IT effectiveness of the company and it would be in place for other organizations to use HP’s internal operations as a showplace of services that it is ready to offer to customers. (July 5, 2007 , “Opinion: Why CIOs Should Pay Attention to Hewlett-Packard” *By Paul A. Strassmann* in <http://www.baselinemag.com>)

In a technology-driven enterprise, the model of knowledge management will have to be catapulted by the drive for innovation and how any major technological advancement is immediately internalized to benefit from the same. The key decision-makers and business drivers in the organization will need the lead time to roll out any new technology in the organization and for this they will have to use the technological benchmark which first used the new technology and gained advantage from the same. This however puts the benchmarked organization in leadership position and the “first-mover” advantage available to the leader may not be available to the other organizations. For instance, copying Microsoft and suing it

as a technology benchmark may only be useful to the extent that Microsoft has already exploited its full potential and the subsequent business benchmarking by other Information technology companies will be subject to myriad restrictions. This also implies that the business decision of the firms using Microsoft for benchmarking will have to keep these intrinsic limitations in mind while adapting to the Microsoft way of making business decisions. The managers will have to keep these challenges before them while picking up their benchmarks.

Another approach to managing management knowledge could be organizational development wherein knowledge gets managed through the inherent systemic metamorphosis of shared values and beliefs through times of continuous change. Peter Senge in his seminal work "*The Fifth Discipline. The art and practice of the learning organization*", London: Random House, (1990: 3) explains that learning organizations are:

"...organizations where people continually expand their capacity to create the results they truly desire, where new and expansive patterns of thinking are nurtured, where collective aspiration is set free, and where people are continually learning to see the whole together."

Any such organization will be able to respond to business exigencies in the shortest possible response time and will be able to optimize their outcomes with highest efficiency levels. If Senge's dimension of knowledge is perennial endeavor then organizations seeking to benchmark will have to quickly identify the current organizational requirement and spot an appropriate industry benchmark to deliver the desired results. Moreover if packaged solutions are available through third-party sources such as external consultants then that will have to be used appropriately. This available knowledge in structured or packaged form will however have to be orchestrated to the needs of the organization and even the know-how of organization's own thought leaders would have to be gainfully employed in solving its problems. This eventually would ensure that the organization has learnt to be a learner and would know which sources of learning could critically relevant to its present business needs.

Let us here consider the example of Transcontinental Media, a printing and publishing business headquartered in Montréal, Quebec, Canada. In this company the HR professional worked in isolation within their specializations and were not well-informed about the business. They basically worked on administrative issues dealing with recruitment, compensation, and employee relations in their respective domain. In order to create an integrated business model between its printing and publishing sectors, the company had to change its culture from a group of small businesses to one integrated publishing company. The business also needed better human capital for meeting future business needs. For this its Hr had to emerge as truly global function. To support this change, they engaged Beverley Patwell of Patwell consulting Inc., an organization development consultant, to help in the development of a transition strategy. In collaboration with the company's internal HR team, the consultant developed a change process which would build on the present strengths and core values of the organization.

Through the implementation of this model of change, the organization could develop competencies which enhanced its self-sustenance as against seeking continual support from external consultants. Every level of the organization which would be impacted by the change was either consulted or involved in the transition process. All the 3 levels of the company such as Corporate, Sector and National HR Team were actively involved in this initiative. This process consisted of six phases, i.e. i) understand ii) assess iii) develop iv) test v) implement and vi) evaluate. Again this process was used in two phases: Phase I consisted of understanding and developing strategy and Phase II consisted of execution. In every cycle, the learning opportunities in the areas of the individual, team, structure, culture and organization were identified and resolved. This entire transition process leveraged upon a clear vision of the organization, systematic planning, and the partnership that was strongly ingrained in the

organizational culture that cherishes collaboration. Thus this win-win organizational development partnership created the necessary transition at Transcontinental Media. (Source: *Evolving Towards An HR Business Partner*, Transcontinental Media, 2004). As delineated by Peter Senge, these are the attributes of a learning organization which enables a culture of sustaining the inherent desire to learn at all time and thus facilitating transition quickly in times of need (as demonstrated in the case of Transcontinental Media). Organizational development led to an integrated system of renewal of knowledge through systemic channels of knowledge management and collaborative work within the organization. Even the use of external consultant is pertinent in enabling this transition.

4. Dispersion of Management Knowledge across the organization

It is not enough to acquire knowledge to help management of the organization. This should go beyond and spread to those niches of the organization which will ultimately gain from this knowledge through application. This dispersion of management knowledge is vital in enabling the organization to leverage from the acquired source of knowledge as this can then enter the systems and processes of the organization to enable it in benefiting from the same.

As Leadbeater has argued, companies will have to invest not merely in new machinery to make production more efficient, but will also have to ensure the flow of know-how that will sustain their business. Organizations will have to be good at knowledge generation, appropriation and exploitation and this process is difficult:

“Knowledge that is visible tends to be explicit, teachable, independent, detachable, it also easy for competitors to imitate. Knowledge that is intangible, tacit, less teachable, less observable, is more complex but more difficult to detach from the person who created it or the context in which it is embedded. Knowledge carried by an individual only realizes its commercial potential when it is replicated by an organization and becomes organizational knowledge.” (*ibid*: 70, 71, Leadbeater, C. (2000) *Living on Thin Air. The New Economy*, London: Penguin.)

The dissemination of management knowledge can happen through several channels such as informal and formal meetings, discussions, and electronic exchanges. However, the management will have to verify the authenticity of the sources of knowledge before using it and even test its concurrent validity. This knowledge would have to be culled from pertinent information sources and will have to be redeployed to the functional and operational domains of the organization where it is needed. This entails streamlining of the knowledge flow within the organization to make it possible for the managers to access any such source at will. While hiring consultants and third-party sources of knowledge, it would be crucial to internalize the acquired knowledge as soon as possible before it escapes the system through lack of use. It may simply happen that the knowledge captured may not be internalized and the organization may expend its resources inappropriately. For this the system should be well in place to channelize any new source into its relevant application within the organization. Often experientially the organization may not be adapt at leveraging upon the knowledge in its practical form and may continue to use the knowledge of the past to manage itself without dispelling the outdated source of information. This makes it important to ensure that the knowledge that is significantly new will have to spread across the organization, at least to those parts where it will be applied. This dispersion must be ensured by the knowledge management praxis of the organization.

5. Managing The knowledge - A Paradox

It is quite self-contradictory to think that as soon as we acquire knowledge, it becomes obsolete as newer forms of knowledge are emerging elsewhere and to break this paradox of the new becoming old, we will have to use ideas, concepts and “thoughtware” by treating this as amorphous and ensuring that they are captured and retained with the larger premise of continuous updating and revalidation. Since this involves resilience of a very high order to make the new available, it would be in place to synchronize all sources of knowledge management and integrate the external sources of knowledge in a perennial form. How any organization can probably break this dichotomy of knowledge capture is a very significant question. This can only be answered by creating adequate receptacles within the organization for managing business knowledge. I. Nonaka (Managing Industrial Knowledge, London: Sage, ed. 2001) has emphasized the interaction between the explicit and inexplicit knowledge. Here if firms are good at knowledge management then there is an organic relation between different types of knowledge. Here the knowledge transfer in case of learnt knowledge such as that which acquired on the organizational shop-floor through trade training or on-the-job learning can be passed between people through direct transfer in a work setting. But if this has to be capture for long-term use then the informal tacit knowledge will have to be captured through a more formal codification of informal knowledge, such as training manuals. This ensures both management of knowledge and its continuous use. Of course a lot of management knowledge-sharing happens in an informal context and that this should be appropriately retained and updated for further use. As any knowledge is meant for a specific purpose and time, its contextualization has to be significantly clear to use it aptly.

There may be external sources from where management knowledge may come into the organization. These sources essentially come from the pressures that any organization faces in its race for survival. These pressures come from external forces such as the government, competition levels in the particular industry, trade and business associations and pressure lobbies and many more. An organization may be forced to adopt a certain type of knowledge which is prevalent in most organizations. For instance, if GE uses a network organization structure then many more multinational organizations are globally likely to sue the same structure. DiMaggio and Powell (P. J. DiMaggio & W. Powell, "The iron cage revisited" institutional isomorphism and collective rationality in organizational fields", *American Sociological Review*, 48 (1983), 147-60) reinforce this by emphasizing the concept of “isomorphism”:

“Organizational structure, which used to arise from the rules of efficiency in the marketplace, now arises from the institutional constraints imposed by the state and the professions. The efforts to achieve rationality with uncertainty and constraint lead to homogeneity of structure (institutional isomorphism).”

This isomorphism transgresses regional barriers and often complicates the rules for management knowledge acquisition. For example setting of BPOs in a big way in country like India, this is a trend followed by all large multinational and transnational organizations. Another problem is that the dissemination of such knowledge happens in an industry-bound and in a highly “must do” mode, leaving no great license for the companies to evolve their own individual way of using the available source of management knowledge. This is to say that organizations are often coerced into using the practices used by industry leaders and other impact-making organizations and here they may have no choice of their own but to borrow the industry practice and do what significant others do. Given this backdrop, managing management knowledge is a tricky proposition. Since on hand, the knowledge needs to grow to be synchronized with current needs and on the other it simply needs to use “accepted ideas, concepts and practices”. This may mean continuous scanning within and without for apt

resources and amply incorporating them to help kill the dichotomy of knowledge management and also to avoid obsolescence. This may resolve the paradox of the new becoming old upon acquisition as continually the transfer of management knowledge will happen and will also inform all business processes through suitable application. Knowledge management practice within the organization will have to consider time, organizational and industry limitations while acquiring and using management knowledge.

6. Developing a Knowledge sharing culture

Every organization needs to internalize the value of knowledge-sharing and learning to emerge as a learning organization as emphasized earlier. Here shared beliefs about knowledge are very significant. Consequently this will create the right milieu for managing every form of knowledge. Whenever the top management of the organization uses a specific manner of acquisition, transfer and application of knowledge, then it is likely that this will be emulated everywhere else in the organization. This particularly holds true in the organizational behavior area, for instance if there are certain behavioral norms then these will be followed across the organization, even if they tend to be not so rational sometimes. This includes styles of leadership, decision-making styles and other area of work-related behaviors. Here it would be quite significant to develop a work culture that is healthy and that which promises to endorse positive behavioral norms and ensure that these are practiced across the organization.

While any senior manager makes a key decision for the organization, he is often watched by one and all in the organization. The information that he seeks and process while making such decision may be an individual habit, but this will get reflected in many more places in the organization since every one who is watching this behavior may get impacted by it. Therefore it would be pertinent for senior managers to ensure that their work-place behaviors reflect the core values of the organizational culture and that this is synchronistic in managing management knowledge. It will be the responsibility of the top managers of the organization to establish the culture of knowledge-sharing. They will have to endorse such practices by reinforcing positively those behaviors which promote knowledge as a value and help in dissemination of the same across the organization. The community of managers within the organization will have to ensure this through informal networks and external endorsements. This will be useful in setting up a culture which will encourage knowledge-seeking and knowledge-sharing as an important managerial strength and will also lead to better management of such knowledge resources within the organization. Peter Senge's learning organization will evidently first have to learn to "learn how to learn as a collective". This achieved, the organization can manage any form of management knowledge more efficiently and in a contextually relevant manner.

7. Conclusion

Management of management knowledge may traverse many domains of knowledge-sharing and is complex process of cross-functional variables. Right from the technical to the behavioral, all the paradigms converge here and therefore managing such knowledge is extremely complicated. While making business decisions, manager uses several important forms of knowledge ranging from third-party consultation to intuition. The use of any given form of knowledge here will depend upon the organization's past practices and current business needs. Due to a knowledge explosion, managers find it exceedingly difficult to juggle with these myriad sources of knowledge and may often look at the industry leaders for doing what may be just right. It is imperative that though management knowledge experiences fads and fashions in terms of what is current and acceptable, organizations also delve into

their “own ways of doing things” . It would be healthy for nay organization to inculcate values which reinforce knowledge-seeking behaviors to help this permeate the culture of the organization.

As the role of a business manager gets more and more complicated so will the mode of knowledge management get more and more complex. To keep in the current loop, the business managers of today will have to smartly work around the intricate web of available knowledge sources and use the one which best addresses its current need, however often this judgment may be heuristic or intuitive. In a knowledge economy where knowledge is the most powerful currency, it would only be pertinent for any organization to ensure that it learns faster than the next competitor in the market. And not just that also use it to ensure that its mental agility is in no way diminished. The knowledge capital of business may be perhaps the only significant determinant of an organization’s success. And therefore business managers will have to ensure that the pertinent management knowledge reaches them first and enables their respective organizations to leverage upon the power of knowledge. Since the first to be informed may be the first to innovate and may also be the first to reach the customer. Here Peter Drucker has the last word on knowledge management as he succinctly encapsulates the significance of knowledge (Managing Knowledge Means Managing Oneself: <http://www.leadertoleader.org/knowledgecenter/L2L/spring2000/drucker.html>):

“To succeed in this new world, we will have to learn, first, who we are. Few people, even highly successful people, can answer the questions; Do you know what you're good at? Do you know what you need to learn so that you get the full benefit of your strengths? Few have even asked themselves these questions.” Once these questions have been answered, then perhaps the management of management knowledge would evidently have happened and would have led to its promise of a more enabled and successful organization.

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SMALL AND MEDIUM ENTERPRISES FROM ROMANIA – PROGRESSIVE GUIDE MARKS AND DEVELOPMENT PERSPECTIVES.

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Abstract

The existence of a powerful sector of small and medium enterprises represents a sine qua non condition of Romania's economic integration within the European Union. In this context, this work wants to present some relevant aspects regarding the evolution of the Romanian small and medium firms, as well as the identification of some action directions which are aiming at the establishment of some stabile and predictable business environment favourable for founding and developing the small and medium enterprises.

1. Introduction

This work wants to approach relevant aspects regarding the problems of the small and medium enterprises, both from the perspective of the main progressive guide marks and from the development policies that must be promoted in the following period. The scientific step starts from the premise that now, the Romanian small and medium enterprises are representing a key sector of the sustainable economic development, an important factor of absorbing the available work force and concomitantly a flexible vector in adjusting the production of goods and services to the volume and structure of the market's demands.

It has been written a lot about the role and the importance of the entrepreneurial activities. We are mentioning here J. Schumpeter, who has introduced the concept of „entrepreneur”, Max Weber, Hovard Stevenson, Peter Drucker, K. Vesper, Jean-Piere Bechard, W.D. Bygrave, M. S. Wartman, D. Muzycza, L.J. Fillion, J. Freeley, J. Miner and others. It is certain that after 1970 the small and medium enterprises sector, especially in the advanced countries, has suffered a remarkable progress, a fact which has determined an increase of the specialists' interest to study the phenomenon, and those who were interested in business, to get involved in this. Thus it results a powerful attraction for the entrepreneurial and an orientation of the state economic policies for supporting this sector. The apparition of this sector after the events from the end of the year 1989 has meant for Romania an alternative opened to the transformations requested by the new way embraced by our economy and society.

The small and medium enterprises have contributed to a faster reorganisation of the large enterprises by hiring the laid off personnel, by exploiting the unused assets and by the externalisation of some activities. The development of the small and medium enterprises has lead to increasing the competition, decreasing the big companies' monopolist role, to increasing the exports and it has generated economic and social alternatives. The existence of the small and medium companies has determined the improvement of the population's economic behaviour, the passing over the obstacles faced by some social disadvantaged groups and the regeneration of some communities affected by the decline of the industry. Also, the active presence of these companies within the economy, within an ascending private

sector, had a favourable impact upon the adjusting potential of the production structures to the dynamic of the economic environment on a national level and within the territorial profile. Despite the difficulties that are characteristic to the transition period, we have witnessed a continuously increase of this microeconomic sector's contribution both in the domain of the gross domestic product's formation and in the domain of employment.

1. The business environment and the small and medium enterprises' development

During the transition period, Romania has enlisted on the direction of the opening and getting close to the advanced countries' economies, the reorganisation and the improvement of the Romanian economy taking place within a process of unification the structures, a process of controlling the resources, of privatisation and reorganising the economic sectors, a process of ensuring a neuter, competitive business environment.

Within the structural reforms implementation, Romania has benefited and it is still benefiting of a support and consultancy from the European Union and from the international financial institutions (The World Bank, The International Monetary Fund, The European Bank for Reconstruction and Development etc.), by programmes of public administration reform from many years, of the justice and the budgetary system, of supporting the privatisation and the reorganisation of the banks and state enterprises, of improving the business environment, of assisting the training for the integration within the economic and institutional structures of the European Union¹.

The policy regarding the business environment has as main goals supporting the private entrepreneurs and the stimulation of the free initiative. For achieving these objectives it was pursued removing the obstacles from the way of the private initiative, within a functional market economy by ensuring the state law, the private property and a powerful middle class as well as the business environment's stability and predictability, the efficient usage of the resources, the free employment, goods, services and capitals circulation, limiting the bureaucracy and diminishing the corruption. In other words, it is about the creation and the development in Romania of a business environment characteristic to a market economy, opened to the affirmation of the entrepreneurial spirit and in the same time capable to encourage the initiation and the development of small and medium businesses.

We can rightfully say that the development of the small and medium enterprises in Romania is influenced by the coordinates specific the autochthonous business environment, for developing the innovative practices to lead to founding enterprises and to consolidating those that are already in the economic relations circuit, and it is also influenced by the motivating and encouraging those attracted by this sector.

Romania's policy regarding the enterprises is addressed to the whole business environment and its main objectives are the encouraging and the facilitation of founding new enterprises, as well as creating a dynamic business environment within each company to have access to the products and services markets from the European Union and other areas of the world.

The multi-annual Programme reserved for the small and medium enterprises and the entrepreneurial spirit was adopted through the Decision no. 2000/819/EC. The programme is focused on the impact that the new economy has created upon the small and medium enterprises and represents an instrument by which Romania, as a member of the European Union, wants to accomplish the objectives stipulated in The European Charter for Small Enterprises².

¹ The Chamber of Commerce and Industry of Romania, The Directorate of Strategy, Inter-institutional Relations, "The state of the business environment", 2007.

² The Judicial Resources Centre, "The small and medium enterprises", Bucharest, 2004.

Basically, the objectives of this programme are the following:

- improving the rate of the economic increase and of the enterprises' competitiveness within an economy based on knowledge and which is wearing the mark of the globalisation phenomenon;
- promoting the entrepreneurial spirit;
- simplifying and improving the administrative and statutory frame for the enterprises so that the research, the innovation and the founding of new companies to be developed;
- improving the financial environment for the small and medium enterprises;
- simplifying the access to the assistance services, to the programmes and the communitarian networks, as well as the adequate coordination of these facilities.

Another recommendation from the European Commission, applied in Romania, is regarding the improvement and the simplifying of the business environment in order to create small and medium enterprises.

The main objectives of this recommendation are the following³:

- stimulating the innovation potential and encouraging the increase of the enterprises;
- creating new jobs within the private sector;
- improving the interface between the public administration and the business environment;
- orientating the public administration towards client and reducing the response time to the enterprises' requests;
- encouraging the foundation of new enterprises by creating a favourable regulation environment.

Concomitant with the application of the European Union's recommendations, Romania has elaborated a strategy which is aiming the development of the small and medium enterprises sector within a dynamic and stimulating business environment⁴.

Simultaneously, to develop this microeconomic sector, The National Agency for Small and Medium Enterprise and Cooperatives has elaborated and launched a pack of multianual national programmes, that are now coordinated by the Minister for small and medium enterprises, trade, tourism and liberal professions. The main multianual programmes that are now in progress are the following:

- The programme regarding the increase of the competitiveness of the small and medium enterprises by implementing and certificating the quality systems;
- The multi-national programme during 2006-2009 to support the small and medium enterprises in developing export;
- The multi-national programme during 2006-2009 to support the access of the small and medium enterprises to training services and consultancy;
- The Programme to support the development of small and medium enterprises with funds to limit the amounts paid for the reinvested profits gross;
- The programme for organising the Small and Medium Enterprises Fair;
- The Programme of development and modernization activities marketing products and services market.

* The recommendation no.97/344/CE regarding the improvement and simplification of the business environment for founding new small and medium enterprises.

³ Idem 2.

⁴ The Government strategy for sustaining the development of the small and medium enterprises in the 2004-2008 period.

2. The progressive guide marks of the small and medium enterprises sector from Romania

In Romania, the small and medium companies have reappeared in 1990* based on the adopting of the Law no. 31/1990** and Law Decree no. 66 and 67/1990***, there was a real “explosion” of new enterprises as a result of the reduced role of the small and medium enterprises during the pre-transition period, which was a result of the over-industrialisation and the discouraging of the private initiative⁵.

From the perspective of the small and medium companies’ evolution, the period after 1990 includes many analysis intervals. Between 1990-1994 there was an accelerated development of the small and medium enterprises as a result of a complex of factors, from which we are mentioning their absence before 1990, the facilities given in the first years of functioning, the legislative frame which was regulating the existence of these companies, as well as the privatisation of the state enterprises.

It is important to mention that the ascension of the small and medium enterprises has taken place during a time when the authorities have been preoccupied especially by solving the macroeconomic problems and they have not orientated especially towards the elaboration of some programmes to support the small and medium companies. In the conditions of a precarious business environment and the lack of some significant economic reforms, the entrepreneurial spirit of an important part of the population and the existent opportunities from the internal market have determined the apparition of a large number of small and medium enterprises that were having a modest economic potential in comparison with other countries that were in transition, like Hungary, Poland and Czech Republic.

After 1994 there have been postponements of the small and medium enterprises’ development materialized in the decreasing of the established small and medium enterprises and the increasing of those who are ceasing their activity. Moreover, the economic force of the companies that managed to maintain on the market was more decreased compared to the previous period. This recoil of the small and medium sector took place based on the unfavourable situation of the national economy and because the small and medium enterprises did not beneficiate from a differentiate treatment⁶.

During 1990-1994 there were established 487900 small and medium companies, while between 1995 and 2001 there were established only 316035 small and medium enterprises. The largest number of companies was matriculated in 1992 (137456 companies) and the smallest number in 1999 (32723 companies).

* The small and medium enterprises have been present within the Romania’s economy until the early’50.

** Law no. 31/1990 regarding the commercial companies.

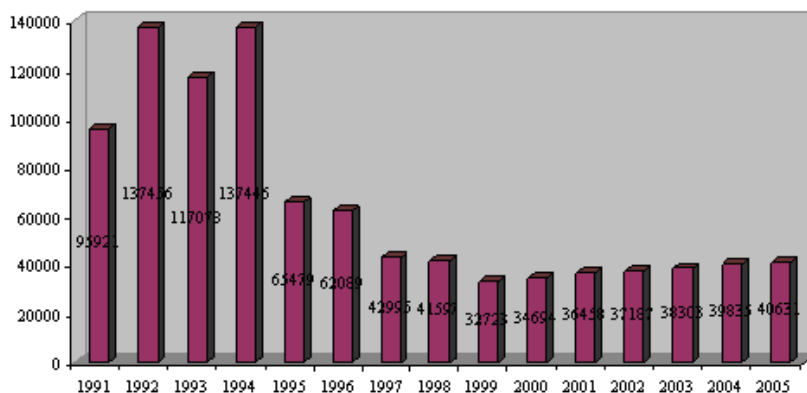
*** The Law Decree. no. 66/1990 regarding the organization and the functioning of the craftsmen cooperative.

The Law Decree no.67/1990 regarding the organization and the functioning of the consumption and credit cooperative.

⁵ Dinu, M., “Romania’s economy. The small and medium enterprises. What we integrate?”, The Economic Publishing House, Bucharest, 2002.

⁶ Ionescu, V., “The small and medium enterprises’ management”, The Economic Publishing House, Bucharest, 2004.

Figure no.1. The evolution of the matriculated small and medium enterprises' number during 1990-2005



Source: The Chamber of Commerce and Industry of Romania
The National Agency for Small and Medium Sized Enterprises and Co-operatives

The year of 1995 has registered the most dramatic reduction of the number of established small and medium enterprises, while between 2000 and 2001 one may notice a slightly re-launching of the matriculation process of the small and medium enterprises, a fact that can be explained through the positive results achieved on the national economy level. Besides, the ascendant trend which the sector of the small and medium enterprises has enlisted on from the matriculation point of view has also continued during the 2002-2006 period.

In 1997, there were 567498 matriculated companies within the Romanian economy, their number decreasing to 636777 in 1999. Regardless of these numbers, we are mentioning the fact that in 1997 only 66.8% of the companies have given a balance sheet, and the percentage has reduced to 63.4% in 2000 and to 61.6% in 2001. Compared to 2001, when the total amount of the small and medium enterprises was of 404526, in 2003 there have been an increase of 51048 companies (112.6%), and in 2004 an increase of 35868 companies (123.7%), which indicates at least from a quantitative point of view a business environment that is favourable to the development of the small and medium enterprises.

An important element in the development of the small and medium companies is the presence of the private capital in this sector. After 1990 we have witnessed a continuously increase of the number of companies with private capital. In the cases of the micro enterprises and of small enterprises, the companies with a private capital were preponderant on the whole analysis interval. Thus, in 1997 the shares owned by the micro enterprises were of 99.6% and respectively of 93%, while in 2004 the shares were of 99.8% and respectively of 97.9%.

But in exchange, the share of the medium private capital enterprises in the amount of the medium enterprises has registered a significant increase, from 57.2% in 1997 to 89.4% in 2001 and to 92.4% in 2004. This ascendant trend of the medium private capital companies has a positive influence within the consolidation of the small and medium enterprises sector from Romania.

Regarding the distribution of the small and medium enterprises on branches of the national economy, the micro enterprises are especially orientated towards trade and services, the small enterprises are active within industry, trade and services, and the medium enterprises are especially carrying on industrial and construction activities. The

presence of the micro enterprises within the trade is explainable by the fact that if we take into consideration the fact that this activity requires a more reduced volume of resources (financial, material, human, etc.) and, in the same time, the possibility of obtaining profit in a rather short period is higher. One of the conclusions that results from the analysis of the data from the Chart no. 1 is that during 1997-2004 the importance of the medium dimension companies has constantly increased. It is worth notifying the fact that the share of the medium companies that are active within the industry in the total of the medium companies has increased from 26.8% in 1997, to 51.5% in the year 2004. From the small and medium enterprises, the medium enterprise is folding the best on the specific of the industrial activity, but the presence of the micro enterprises and the small companies within this sector must not be neglected. In 1997, 7.8% between the micro enterprises were carrying out industrial activities, the share being increased to 9.5% in 2001 and to 10.1% in 2004. Given the fact that the industry represents one of the pillars of the durable development, we believe that the more active involvement of the small and medium enterprises in this activity branch represents an important premise of the economic increase.

Within the services area one can notice stability from the share of those three categories of enterprises point of view – the micro enterprises, the small and medium enterprises – in the amount of each size class. In 1997 the shares were of 14.1%, 13.3% and 10.7%, and in 2004 these were very close, respectively 17.5%, 13.4% and 11.2%. Regarding the division on regions of the small and medium enterprises, there are certain differences from the enterprises' concentration point of view. Thus, as it results from the Chart no. 2, in the region of Bucharest almost 115000 companies are active, a number which represents 21.82% of the total of small and medium enterprises from Romania. In the same region, the share of the small and medium enterprises in the whole companies is of 2.82% times higher than in the South West region and it is twice bigger than in the North West region. These data are highlighting significant differences from the development of the entrepreneurial environment point of view within the areas of the country.

The small and medium enterprises' distribution on regions of development

Chart no. 2

| Region | 2001 | | 2003 | | Dynamics % |
|----------------|-----------|-----------|-----------|-----------|---------------|
| | Companies | Share (%) | Companies | Share (%) | |
| 1 – North East | 47.275 | 11.68 | 52.071 | 11.43 | 110.14 |
| 2 – South East | 53.723 | 13.28 | 58.824 | 12.91 | 109.49 |
| 3 – South | 46.468 | 11.49 | 50.738 | 11.14 | 109.18 |
| 4 – South West | 36.728 | 9.10 | 38.889 | 8.54 | 105.88 |
| 5 – West | 35.204 | 8.70 | 40.968 | 8.99 | 116.37 |
| 6 – North West | 55.209 | 13.66 | 63.465 | 13.93 | 114.95 |
| 7 – Centre | 48.921 | 12.09 | 55.741 | 12.24 | 113.94 |
| 8 – Bucharest | 80.908 | 20.00 | 94.868 | 20.82 | 117.25 |
| Total | 404.526 | 100 | 455.574 | 100 | 112.62 |

Source: CNIPMMR, ANIMMC, „The White Charta of the SMEs from Romania”, Olimp Publishing House, Bucharest, 2006.

The small and medium enterprises' distribution on regions of development

Chart no. 2 - continuation

| Region | 2004 | | 2005 | | Dynamics % |
|----------------|-----------|-----------|-----------|-----------|---------------|
| | Companies | Share (%) | Companies | Share (%) | |
| 1 – North East | 56.094 | 11.21 | 57.352 | 10.90 | 102.24 |
| 2 – South East | 63.226 | 12.64 | 67.861 | 12.89 | 107.33 |
| 3 – South | 54.861 | 10.96 | 55.502 | 10.54 | 101.16 |
| 4 – South West | 41.261 | 8.25 | 40.733 | 7.74 | 98.72 |
| 5 – West | 45.903 | 9.17 | 48.455 | 9.20 | 105.56 |
| 6 – North West | 70.077 | 14.00 | 75.557 | 14.35 | 107.82 |
| 7 – Centre | 62.117 | 12.43 | 66.122 | 12.56 | 106.44 |
| 8 – Bucharest | 106.795 | 21.34 | 114.736 | 21.82 | 107.43 |
| Total | 500.394 | 100 | 526.318 | 100 | 105.18 |

Source: CNIPMMR, ANIMMC, „The White Charta of the SMEs from Romania”, Olimp Publishing House, Bucharest, 2007.

Analysing the density of the small and medium enterprises on a territorial level, one may notice the fact that the Bucharest region is on the first place of the hierarchy having a density of 51.96 companies/1000 inhabitants, followed by the North West region with a density of the small and medium enterprises of 15.36 companies/1000 inhabitants. The data presented in the Chart no. 3 are emphasizing the economic discrepancies that exist between the country's regions regarding the small and medium enterprises' density⁷.

It is important to highlight the fact that the small and medium enterprises' density has enlisted on an ascendant trajectory in all the country's regions. For example, in Bucharest, the density of the small and medium enterprises has increased from 35.41 companies/1000 inhabitants in 2001, to 43 companies/1000 inhabitants in 2003 and to 51.96 companies/1000 inhabitants in 2005. In the North West region, being in the second position of the hierarchy, the density of the small and medium enterprises has increased from 19.44 companies/1000 inhabitants in 2001, to 23.12 companies/1000 inhabitants in 2003 and to 27.60 companies/1000 inhabitants in 2005.

The density of the small and medium enterprises on regions of development

Chart no. 3

| Region | 2001 | 2003 | 2004 | 2005 |
|----------------|--|--|--|--|
| | Number of companies for 1000 inhabitants | Number of companies for 1000 inhabitants | Number of companies for 1000 inhabitants | Number of companies for 1000 inhabitants |
| 1 – North East | 12.36 | 13.91 | 15.00 | 15.36 |
| 2 – South East | 18.31 | 20.58 | 22.18 | 23.84 |
| 3 – South | 13.41 | 15.11 | 16.42 | 16.67 |
| 4 – South | 15.30 | 16.70 | 17.80 | 17.66 |
| 5 – West | 17.25 | 20.83 | 23.67 | 25.10 |
| 6 – North | 19.44 | 23.12 | 25.59 | 27.60 |
| 7 – Centre | 18.51 | 21.90 | 24.49 | 26.13 |
| 8 – Bucharest | 35.41 | 43.00 | 48.38 | 51.96 |
| Total | 18.03 | 20.94 | 23.09 | 24.34 |

Source: CNIPMMR, ANIMMC, „The White Charta of the SMEs from Romania”, Olimp Publishing House, Bucharest, 2007.

⁷ The National Council of Small and Medium Sized Private Enterprises in Romania și The National Agency for Small and Medium Enterprise and Cooperatives, „The White Charta of the SMEs from Romania”, Olimp Publishing House, Bucharest, 2007.

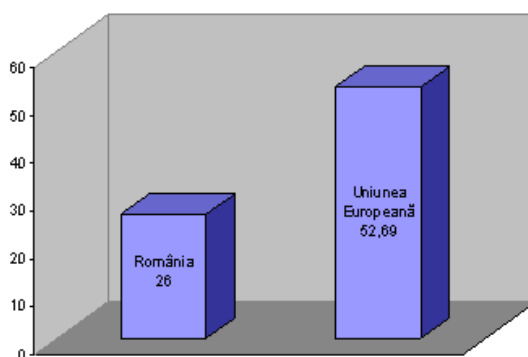
The sector of the small and medium companies represents one of the main vectors of Romania's economic development in the post-adhesion period. The existence of a powerful small and medium enterprises segment constitutes a sine qua non condition of the integration of the Romanian economy in the economic architecture of the communitarian space. The real potential of the Romanian small and medium companies may be evaluated by a comparative analysis with the European Union, an analysis structured on two coordinates: the density of the small and medium companies and their distribution on activity branches.

The density of the small and medium enterprises reflects the development stage of the entrepreneurial phenomenon. The relevance of this strategic meter is argued by a series of recent researches which have proved that there is a positive correlation between the rate of growth of the Gross Domestic Product and the rate of growth of the active companies. The increase of the active companies is basically ensured by the development of the small and medium companies⁸.

The density of the small and medium enterprises from Romania is of 26 companies/1000 inhabitants, a lot more inferior to the density on the ensemble of the European Union (52.69 companies/1000 inhabitants). This difference indicates the effort that our country must make on an economic level to be structural compatible with the communitarian economy, the only solving variant of the specific integration within the European Union.

The development of the entrepreneurial system enforces an advanced degree of institutional structuring of the competitive market economy, as well as profound mutations of cultural type on the society's level. From these, we are mentioning the gradual reduction of the dependence upon etatist intervention within economy, the development of the organising autonomy and of the initiative spirit, creating new visions about the risks and the habit of taking action on uncertainty conditions, accepting the social statute differences induced by the correct and undistorted functioning of the markets.

Chart no. 2. The density of the small and medium companies from Romania and the European Union



Source: ANIMMC, "A study regarding the competitiveness of the small and medium enterprises sector", 2006.

⁸ Dinu, M., Mereuță, C., Țurlea, G. and others. "The entrepreneurial development and the structural analysis of the small and medium companies", in the volume "The structural analysis of the Romanian companies' system from the perspective of the Romania's integration in the European Union", The reflection group of the Romanian Academy, Bucharest, 2002.

⁹The National Agency for Small and Medium Enterprise and Cooperatives, "A study regarding the competitiveness of the small and medium enterprises sector", 2006.

In order to ensure the comparison terms between Romania and the European Union regarding the distribution of the small and medium companies on economic branches it has been used the communitarian methodology of sectorial aggregation which includes seven main activity domains. These are industry and energy, construction, trade, hotels and restaurants, transportation and telecommunications, financial activities, services provided by entrepreneurs and other services.

In industry, the share of the Romanian small and medium companies is of 14.2%, which means that it is superior to the share of the European Union which is of 11.8%. In our opinion, this constitutes a positive aspect in the integration perspective. The development of the small and medium enterprises from the industry is from the share's point of view more close to the countries that have an advanced economy like Italy, Denmark, Finland and Sweden.

In constructions, the small and medium enterprises have a smaller share than the communitarian average, but in the last couple of years the number of companies that are active within this domain has significantly increased. At the same time, there have taken place the division of some big construction units, concomitant with the apparition of some companies specialised in surrounding operations, dwelling maintenance, modernising the interiors, etc. a coordinate of the entrepreneurial phenomenon in Romania is represented by the orientation of the small and medium enterprises towards commercial activities, over two thirds of these having a predominant commercial feature. In transportation and telecommunications, the small and medium enterprises have a share of 4.5% which is below the 5.3% average of the European Union. The perspectives of the small and medium enterprises from this sector are optimistic under the conditions of the development of the tourism and the telecommunication services. The modernisation of the payment forms from economy, the creation of the performance investments funds and the private pension funds have encouraged the establishing of new companies within the financial domain. The share of the small and medium enterprises within the services area provided for the enterprises and within other services is more inferior to the communitarian average, a fact which constitutes a critical point of the Romanian small and medium enterprises segment.

4. Policies and development perspectives of the small and medium enterprises

In the context of the presented progressive guide marks, we believe that the development policies of the small and medium enterprises from Romania must be structured particularly on the following main coordinates:

- Creating a business environment that is encouraging the founding and the development of the small and medium enterprises;
- The development of the competitiveness ability of the small and medium companies;
- Improving the small and medium enterprises' access to financing;
- Improving the small and medium enterprises' access on the external markets;
- Promoting the entrepreneurial culture and strengthening the managerial performances.

The existence of some policies and of a regulation frame to allow the enterprises to operate and to develop themselves in an adequate competitiveness environment is fundamental for supporting the increase of the small and medium enterprises sector. In this way, Romania continues to harmonize the legislation with the stipulations of the communitarian acquis, to introduce measures as to counteract the administrative and technical obstacles, to develop a coherent institutional frame for elaborating and implementing the

specific policies and to improve the dialog between the government's institutions, the social partners and the structures of representing the interests of the small and medium enterprises for maximizing the sector's development efforts.

In the same time, the government, The National Agency for Small and Medium Enterprise and Cooperatives (ANIMMC), has created a platform for an efficient absorption of the Structural Funds. ANIMMC has elaborated and has adopted a series of specific measures for developing the institutional ability and the human resources on a national and regional level, as well as for strengthening the collaboration with the Regional Development Agencies. The development of the competitiveness ability of the small and medium enterprises is accomplishing through:

- The support given to the small and medium enterprises regarding the access to new technologies;
- Supporting the small and medium enterprises in introducing the quality standards and the systems of quality management;
- Promoting the advantages offered by the e-business techniques, as well and increasing the human potential for introducing and supporting an e-business platform in Romania;
- Facilitating the access to the available assets of the enterprises having a majority state capital and the public acquisitions;
- Improving the access of the small and medium enterprises to quality consultancy services;
- Supporting the businesses incubators in the production and services domains that are creators of higher added value;
- Developing the autochthon and foreign investments in the innovative production activities by creating industrial parks;
- The small and medium enterprises' participation to the reduction of the regional economic disparities.

Regarding the small and medium enterprises' access to financing sources, the Romanian banking system has lately suffered important transformations. Nevertheless, the small and medium enterprises are still facing difficulties regarding the access to financing. The credits are available, but the credit conditions used by the banking system are difficult to access by the small and medium enterprises. The credits and the working capital on a long term are less sustained. The banks are demanding the small and medium enterprises interest rates for the requested credits that are difficult to cover mainly because of the capital removal and the lack of requested guaranties. Thus the micro enterprises and the small enterprises do not have development possibilities and the entrepreneurs cannot penetrate the market with innovative ideas and products.

Improving the access to financing of the small and medium companies is supported through a series of measures, such as:

- Stimulating the capitalisation of the productive small and medium enterprises;
- Sustaining the apparition of a national network of Guarantee Funds for the small and medium enterprises;
- Financing the new established enterprises within the sectors with priority of the national economy;
- Pilot models of innovative financial instruments for the small and medium enterprises.

Improving the small and medium enterprises' access on the external markets represents a priority that results both from the need of accomplishing the economic objective of sustained increase of the small and medium enterprises' exports, and from the analysis of the real export potential of the small and medium enterprises from representative economic sectors in which Romania is seen as being competitive. There are few Romanian small and

medium companies that have the ability to find a market, a partner or an adequate client without resorting to some forms of internal or external assistance.

Improving the small and medium enterprises' access on the external markets is done especially by stimulating the development of the cross border cooperation and of the business partnerships as well as by supporting the small and medium enterprises in the export activity. Promoting an entrepreneurial culture and strengthening the managerial performances constitutes an important coordinate of the strategy of creating a stabile business and developing environment of the small and medium enterprises' segment from Romania.

A distinct feature of the advanced economies is represented by the vital role of the entrepreneurship as a central pillar of the economic increase. The entrepreneurs are founding companies, thus creating new jobs. Also, the technological process is generating new businesses and is determining the development of those existent already, thus constituting an essential factor for adjusting to the opportunities that come up on the market, for acquiring new knowledge and for increasing the productivity.

The measures and the actions within this priority is aiming the development of the entrepreneurial abilities and spirit, by supporting the young men's and other segments of the active population's access to a continuous vocational training. Concomitant, it is intended to promote a new attitude among the public regarding the entrepreneurship by involving the mass-media and other modern means of information. The insufficiency of the promotional and supplying materials and basic information useful for increasing the interest towards entrepreneurship must be compensated by launching some publications, manuals, information reports and periodical magazines centred on the entrepreneurship's problems.

For developing the entrepreneurial spirit, a new generation of entrepreneurs must be encouraged, a generation having characteristic abilities like responsibility, spontaneity, adaptability, clear-sightedness, initiative and managerial spirit to allow them to identify and apply some efficient strategies of penetrating and maintaining on the market.

One of the major direction which must not be neglected by all those that are interested in developing the entrepreneurial spirit and the small and medium enterprises, is the orientation and the support of the small and medium businesses from the new domains promoted by the knowledge economy. The explosion of the knowledge and based on this the shaping and the consolidation of a new type of economy, open new opportunities for the small and medium enterprises. The specialists believe that the small and medium enterprises will constitute in the following period the main vector of the economic progress. Being supplier, with reaction possibilities that are faster than the big enterprises, they can reevaluate on a superior level the knowledge resource towards renewing their activity on all the plans. Thanks to the reduced dimension and the more flexible organisational structure, the small and medium enterprises may accomplish during their existence numerous changes, from orientating again the market strategy and reorganising the management, to rethinking the activity profile, a fact which allows them to rapidly assimilate knowledge and to open their appetite for reevaluating the knowledge in order to produce new knowledge.

In this context, the small and medium enterprises have two major action direction opened in front of them:

- strengthening out the "classical" business opportunities under the new conditions, respectively emphasizing them by resorting to the new technologies based on knowledge;
- orientating on the new business opportunities that appear as a result of proceeding to the economy based on knowledge (the internet and all that concerns the communication technology, the electronic trade, the nanotechnologies, the technologies based on artificial intelligence, the e-activities, etc.).

The small and medium enterprises being characterised through a high adaptability to the changes that take place within the business environment will rapidly orientate themselves towards new action directions becoming an extremely dynamic sector of the contemporary economy.

The entrepreneurship is multidimensional, combining the risks, the creativity and/or the innovations with the managerial attitude. This implies the individual's motivation and ability to identify an opportunity and to take action with the purpose of producing an added value or an economic success. In this context, it is necessary to promote the training courses of the small and medium companies' managers in order to lead more efficiently their own companies and to adopt management styles to determine the increase of the competitiveness.

5. Conclusions

Romania has crossed in the last years a series of important stages regarding the creation of a stabile and predictable business environment that is favourable to the development of the small and medium enterprises sector. The efforts made until this moment must be continued because the existence of a stimulating, dynamic and attractive business environment for the investors, as well as the development of the small and medium companies constitute fundamental premises of Romania's economic integration within the European Union.

Romania must carry on the promoting of a coherent strategy on a long term, sustained by a pack of sectorial policies that aim at the development of the small and medium companies. In our opinion, the main targets of this pack of sectorial policies are the consolidation of the small and medium enterprises from the industry, the continuation of the ascendant trend within the construction sphere, encouraging the private initiative within the agricultural domain, as well as the increase of the small and medium companies' number that are orientated towards activities that are specific to the economy based on knowledge from the services sector, especially of those that are carrying on financial activities and are providing services for the enterprises.

The development of the competitiveness ability of the small and medium enterprises represents one of the strategic targets of the policies promoted within this domain. In this way, there must be enlarge the measures that aim especially at the support given to the small and medium enterprises regarding the access to the new technologies, supporting the companies in introducing the quality standards and the systems of the quality management, improving the access to consultancy services, as well as the development of the autochthon and foreign investments within the innovative production activities, by creating industrial parks.

Improving the access of the small and medium enterprises to financing sources must be supported by stimulating the capitalisation of the companies that are carrying out productive activities, by developing a national network of Guarantee Funds for the small and medium enterprises and by financing the new established enterprises from the national economy's priority sectors.

Promoting an entrepreneurial culture and increasing the managerial performances also imply the initiation of some actions that are aiming at the development of some abilities and the entrepreneurial spirit, the formation of a new attitude among the public regarding the entrepreneurship, launching some publications, information reports and periodical magazines centred on the small and medium enterprises' problems, as well as encouraging a new generation of entrepreneurs to allow them to identify and to apply some efficient strategies of penetrating and maintaining on the market. Concomitant, it is necessary to promote the training courses for the managers of the small and medium companies with the purpose of

increasing their abilities to efficiently lead their own companies and adopt management styles to determine the increase of the competitiveness.

There is a reciprocity relation between the development of the small and medium enterprises and between the business environments. On one hand, a stabile and predictable business environment is favouring the manifestation of the private initiative, the establishing of enterprises and, thus, the development of the small and medium enterprises' sector. On the other hand, a powerful small and medium enterprises sector constitutes an important balancing factor within the economic and social plan, determining in the same time the intensification of the competitiveness on the market, the increase of the products' and services quality that are offered to the requesters, as well as the diversification of this offer. Thus there are created the premises of configuring and then consolidating a stimulating and dynamic business environment that is attractive both from the investors from our country, as for those that are abroad.

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The distribution of the small and medium enterprises on activity branches and class size

-%- Chart no.1

| Years Activity branch Size class | 1997 | | | 1998 | | | 1999 | | | 2000 | | |
|--|-------|-------|--------|-------|-------|--------|-------|-------|--------|-------|-------|--------|
| | Micro | Small | Medium | Micro | Small | Medium | Micro | Small | Medium | Micro | Small | Medium |
| Industry | 7.8 | 26.7 | 26.8 | 9.0 | 29.5 | 32.0 | 9.4 | 29.6 | 34.9 | 9.1 | 30.2 | 46.8 |
| Agriculture | 1.2 | 6.1 | 17.5 | 1.2 | 5.3 | 14.0 | 1.4 | 5.3 | 11.8 | 1.6 | 3.8 | 4.1 |
| Constructions | 1.8 | 9.9 | 17.5 | 1.8 | 9.6 | 16.4 | 2.1 | 9.5 | 16.1 | 2.2 | 9.2 | 15.1 |
| Trade | 71.7 | 39.1 | 17.2 | 70.6 | 40.7 | 18.1 | 69.3 | 40.6 | 17.8 | 68.2 | 40.4 | 16.9 |
| Tourism | 0.8 | 2.7 | 3.1 | 0.4 | 0.9 | 2.1 | 0.4 | 0.9 | 2.1 | 0.4 | 0.8 | 1.5 |
| Transportation | 2.5 | 2.1 | 7.1 | 2.5 | 2.0 | 6.4 | 2.6 | 2.3 | 6.0 | 3.0 | 3.3 | 4.7 |
| Services | 14.1 | 13.3 | 10.7 | 14.6 | 12.0 | 11.0 | 14.8 | 11.7 | 11.2 | 15.4 | 12.3 | 10.9 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: The National Agency for Small and Medium Enterprises and Cooperatives
The Chamber of Trade and Commerce of Romania

The distribution of the small and medium enterprises on activity branches and class size

-%- Chart no.1 - sequell

| Years Activity branch Size class | 2001 | | | 2002 | | | 2003 | | | 2004 | | |
|--|-------|-------|--------|-------|-------|--------|-------|-------|--------|-------|-------|--------|
| | Micro | Small | Medium | Micro | Small | Medium | Micro | Small | Medium | Micro | Small | Medium |
| Industry | 9,5 | 30,0 | 49,0 | 9,7 | 30,5 | 50,2 | 9,8 | 31,0 | 50,4 | 10,1 | 31,3 | 51,5 |
| Agriculture | 1,8 | 3,7 | 3,6 | 1,9 | 3,3 | 2,3 | 1,9 | 2,3 | 1,8 | 2,0 | 1,3 | 2,6 |
| Constructions | 2,7 | 9,0 | 15,2 | 2,8 | 9,0 | 15,3 | 3,0 | 9,1 | 15,5 | 3,2 | 9,2 | 15,6 |
| Trade | 65,5 | 40,2 | 15,4 | 65,0 | 40,2 | 15,2 | 64,1 | 40,1 | 15,0 | 62,9 | 40,0 | 13,1 |
| Tourism | 0,5 | 0,9 | 1,6 | 0,5 | 0,8 | 1,6 | 0,6 | 0,9 | 1,7 | 0,7 | 1,0 | 1,8 |
| Transportation | 3,5 | 3,6 | 4,4 | 3,5 | 3,6 | 4,3 | 3,6 | 3,7 | 4,3 | 3,6 | 3,8 | 4,2 |
| Services | 16,5 | 12,6 | 10,9 | 16,6 | 12,6 | 11,1 | 17,0 | 12,9 | 11,3 | 17,5 | 13,4 | 11,2 |
| Total | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 | 100,0 |

Source: The National Agency for Small and Medium Enterprises and Cooperatives
The Chamber of Trade and Commerce of Romania

PRIORITIZING HIGHER EDUCATION BALANCED SCORECARD PERFORMANCE INDICATORS USING FUZZY APPROACH IN AN IRANIAN CONTEXT

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Abstract

Higher education institutes are facing new challenges in order to improve the quality of education. There is a pressure for restructuring and reforming higher education in order to provide quality education and bring up graduates who become fruitful members of their societies. In higher education as in business there are acceptable conventions of measuring excellence. As a result, the implementation of Balanced Scorecard in higher education has been a target of interest in recent years. However, rather than emphasizing on financial performance, higher education has emphasized on academic measures in its Balanced Scorecard.

This paper aims to prioritize performance indicators within the higher education balanced scorecard using fuzzy TOPSIS technique.

Because Fuzzy Theory is a better approach in comparison to Logical Theory in case of measuring linguistic terms, therefore this paper tries to apply a fuzzy approach in prioritizing the performance indicators introduced by Balanced Scorecard.

Keyword: *Balanced Scorecard, Performance Indicators, Higher Education, Fuzzy TOPSIS, Fuzzy Logic*

Introduction

Nowadays, the role of human capital in economical growth and development can not be ignored. Higher education, as the most important source of educating skilled people, is an important way of forming rich human capital through providing high quality education (Karname Hagi and Akbari, 2004). According to Iran's 20-year development plan (1404 Plan), by the year 2025, Iran is a developed country which holds number one rank in the region in the areas of economics, technology and education. Therefore, for Iran, in order to reach the planned educational position in the region, it is measure its universities' performance using performance measurement systems and make improvements. One of these performance measurement systems is balanced scorecard which has been introduced by Kaplan and Norton and widely applied by various organizations during the previous years (Kaplan and Norton, 1992, 1993, 1996a, 2000). The reason for use of the balanced scorecard is to formulate

strategy objectively in the four perspectives, considering their multidimensional effect (Epstein and Roy, 2004). Balanced scorecard (BSC) measures performance measurement within four perspectives based on several defined performance indicators. Although these indicators are inter-connected to reach to organizational vision and mission, still BSC fails to provide any relationship between the importance of each of these indicators. Therefore, this paper tries to fill this gap by studying and prioritizing the performance indicators defined in the balanced scorecard of an Iranian university.

First, this paper overviews the issues of quality in higher education. Later it reviews Balanced Scorecard and its applications in higher education. And eventually in the methodology section, it seeks to prioritize the performance indicators related to Yazd University Balanced Scorecard model.

Quality in higher education

Quality in higher education is a complex and multifaceted concept and a single appropriate definition of quality is lacking (Harvey and Green, 1993). As a consequence, consensus concerning “the best way to define and measure service quality” (Clewes, 2003, p. 71) does not as yet exist. The concerns regarding the concept of quality in higher education are clearly expressed by Barnett (1994, p. 68):

“What counts as quality is contested. The different views of quality generate different methods of assessing quality and in particular alternative sets of performance indicators (PIs). However, PIs are highly limited in their informational content, and have nothing to tell us about the quality of the educational process.”

The key issue is the ability of the quality concept to facilitate the perspectives of a range of stakeholders who have differing conceptions of higher education. The concern is that there will be a direct relationship between the conception of higher education being taken, the definition of quality being used and the performance indicators chosen to measure quality. The challenge is to overcome these concerns and produce a performance evaluation framework that permits the equal expression of legitimate voices, though they may conflict or compete in some ways (Tam, 2001).

The balanced scorecard

Kaplan and Norton (1996b) developed the BSC in the early 1990s. According to them, “the BSC translates an organization’s mission and strategy into a comprehensive set of performance measures and provides the framework for strategic measurement and management”. Traditionally, most organizations look into their corporate performance by reviewing their financial aspects. However, financial measures alone are not a balanced view of the critical success factors of any organizations, mainly because financial measurements tend to measure the past. Therefore, what if an organization knows what has happened, if there are no explanations of “Why it has happened”.

The BSC are based on four key perspectives; they are the:

- (i) Financial goals - How will we look to our stake holders?
- (ii) Customer perspective - How must we look to our customers?
- (iii) Internal processes - What internal processes must we excel at?
- (iv) Learning and growth - How can the organization learn and improve? (Sanger, 1988)

Balanced scorecard applications in higher education

The progression from monitoring to the management of quality in education requires the adoption of a system which is aimed not only at performance measurement, but also at streamlining and focusing strategy towards the objectives of the various stakeholders (Kaplan and Norton, 1996b, 2000). In order to be successful, the scorecard also needs to be rooted in the employees' internal commitment (Nørreklit, 2000) and this requires the involvement of staff (Simons, 1995) in the development of performance management decisions.

It is evident that the BSC has been widely adopted in the business sector but the education sector has not embraced the BSC concept widely as indicated by the dearth of published research on this topic (Karathanos and Karathanos, 2005). Cullen *et al.*, (2003) proposed that BSC be used in educational institutions for reinforcement of the importance of managing rather than just monitoring performance. Sutherland (2000), (cited in Umashankar and Dutta, 2007) reported that the Rossier School of Education at University of Southern California adopted the BSC to assess its academic program and planning process. Also Chang and Chow (1999) reported in a survey of 69 accounting departments' heads that they were generally supportive of the BSC applicability and benefits to accounting education programs. Umashankar and Dutta (2007) proposed a BSC model which can be applied to Indian higher education programs/institutions. Papenhausen and Einstein (2006) lay out a comprehensive and content-specific BSC for a business school as a whole. Authors propose that in an environment that demands increasing accountability from business schools, the Balanced Scorecard Approach offers a promising and valuable tool for implementing a strategic performance management system in a college of business.

Balanced scorecard in Yazd university school of humanities

Balanced scorecard has been used to measure the performance of Yazd University School of Humanities. For this purpose, strategy map of the under study school has been drawn. Through such a strategy map, the cause-and-effect linkage can be better described, and strategy can be more clearly defined to examine the validity of examining strategy and school growth. A strategic map not only links with strategic targets, but also includes measurable indicators of different perspectives. Figure 1, shows the strategy map of Yazd University School of Humanities based on BSC approach.

Fig. 1: Strategy Map of Yazd University School of Humanities

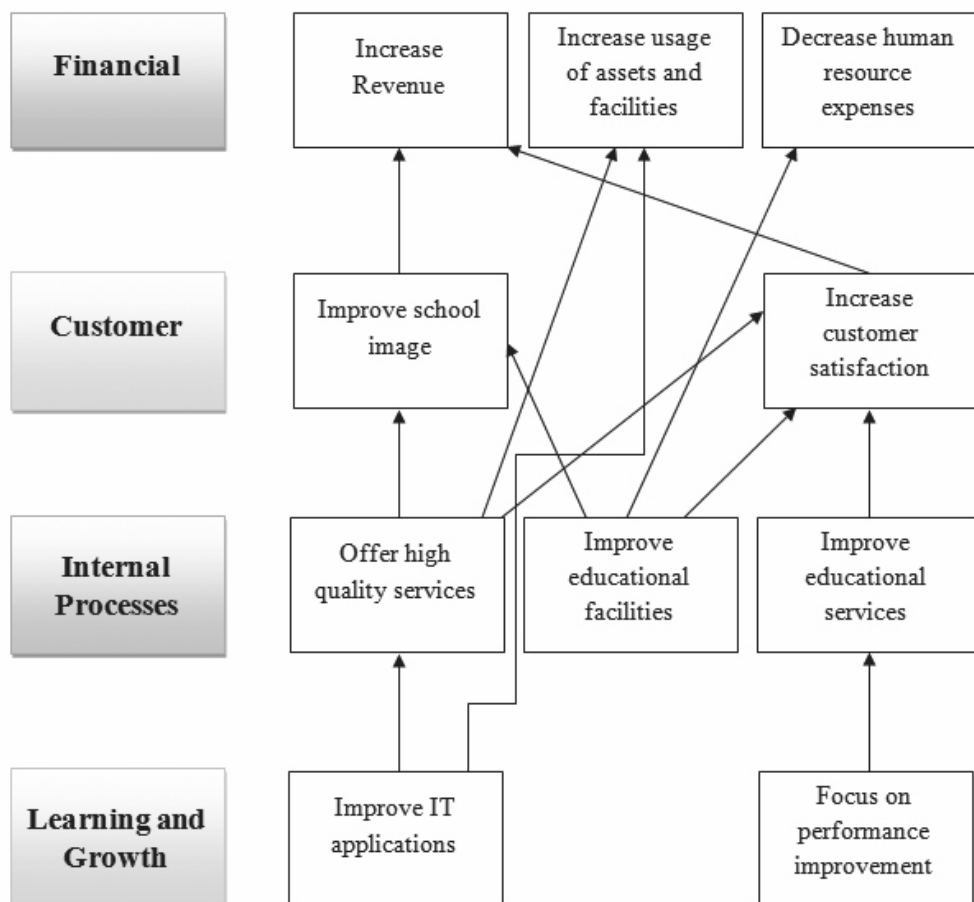


Table 1, shows the performance indicators which have been defined for the school performance assessment:

Table 1: Yazd University School of Humanities Performance Indicators in BSC Approach

| Perspective | Performance Indicator |
|---------------------|---|
| Financial | Annual revenue from tuition in comparison to annual devoted budget |
| | Value of contracts with industry per year in Rials in comparison to annual devoted budget |
| | Total fund raised in Rials |
| | Value of raised services and aids from outside university sources in Rials |
| | Average life cycle of facilities and equipments |
| | Average usage of library services (book per student per month) |
| | Average cost of educational staff (in million Rials) |
| | Average cost of administrative staff (in million Rials) |
| Customer | Students' satisfaction grade (1 to 10 scale) |
| | Academic staff's satisfaction grade (1 to 10 scale) |
| | Number of complaints made per month |
| | Increase in students' tendency to enter school |
| Internal Process | University's position in national and international rankings |
| | Students' satisfaction level from school's administrative staff performance (1 to 10 scale) |
| | Students' satisfaction level from school's internal processes (1 to 10 scale) |
| | Ratio of students to academic staff in bachelor degree programs |
| | Ratio of students to academic staff in master and PhD degree programs |
| | Average cycle for renewing educational facilities and equipments |
| | Time cycle for up-to-dating the computer and IT equipments of the school |
| | No. of International students enrolled in comparison to total no. students at school |
| | Students' satisfaction from education |
| | Average no. of papers by academic staff published in conferences per year |
| | Average no. of papers by academic staff published in ISI journals per year |
| | Average no. of papers by academic staff published in refereed research journals per year |
| | Ratio of using office automation in processes |
| | No. of online programs offered by school |
| Learning and Growth | Ratio of using computer in processing and keeping documents |
| | Amount of performance-based culture availability |

The objective of this paper is to rank BSC performance indicators in Yazd University School of Humanities. The following section describes the methodology and its findings.

Methodology

There are various models for prioritizing factors in research. The most important models are Multiple Criteria Decision Making (MCDM) models such as AHP¹, TOPSIS², etc. In this paper, we try to apply Fuzzy TOPSIS model, introduced by Chen (1997) for prioritizing performance indicators within the higher education balanced scorecard using fuzzy TOPSIS technique. Study sample society was randomly selected from the university professors of Yazd University, school of humanities. Totally, 90 questionnaires were distributed among which 78 questionnaires were returned (return rate of 86.7%). Table 2 shows the characteristics of the sample society.

Table 2: Sample Characteristics

| Factor | | Frequency | Percentage |
|----------|---------------------|-----------|------------|
| Position | Lecturer | 3 | 4% |
| | Assistant Professor | 58 | 74% |
| | Associate Professor | 15 | 19% |
| | Professor | 2 | 3% |
| Gender | Male | 73 | 94% |
| | Female | 5 | 6% |

Questionnaire development, validity and reliability

In order to prioritize the performance indicators within the higher education balanced scorecard in an Iranian context, the performance indicators were driven from Balanced Scorecard model. The required data was gathered in the form of a questionnaire asking the respondents to choose the importance of the mentioned indicators based on a Likert scale, with a ranking of: 1 very low; 2 low; 3 relatively low; 4 fair; 5 relatively high; 6 high; and 7 very high. Prioritizing the factors was done using the Fuzzy TOPSIS. The numerical value of each linguistic term used in the questionnaire, was determined based on the table 3 (Ching *et al.*, 2005).

Table 3: Fuzzy range and numbers

| Linguistic term | Fuzzy Number |
|-----------------|------------------|
| 1 | (0, 0.05, 0.15) |
| 2 | (0.1, 0.2, 0.3) |
| 3 | (0.2, 0.35, 0.5) |
| 4 | (0.3, 0.5, 0.7) |
| 5 | (0.5, 0.65, 0.8) |
| 6 | (0.7, 0.8, 0.9) |
| 7 | (0.85, 0.95, 1) |

¹ Analytic Hierarchy Process

² Technique for Order Preference by Similarity to Ideal Solution

Because the questionnaire used in this research is a simple questionnaire for measuring the importance of several items and similar questionnaires have already been used in previous studies, its validity is confirmed. In order to test the reliability of the questionnaire, Cronbach's Alpha was found to be 0.813, which indicated that the questionnaire has high internal reliability.

Measurement with fuzzy set

The subject of service quality is burdened by fuzzy terms or buzzwords (e.g. attitude, taste, atmosphere), and respondents may fill out the questionnaire subjectively based on their unique experience or personal characteristics. This subjective assessment is intrinsically imprecise and ambiguous (Williams and Zigli, 1987). To reflect the subjectivity and imprecision in the survey, the assessment made by the respondents can be represented as fuzzy sets (Yeh and Kuo, 2003). Fuzzy set theory, initially introduced by Zadeh (1965), is used to manage the vagueness of human thought, since it can represent vague expressions such as "usually," "fair" and "satisfied," which are regarded as the natural representation of respondents' preference and judgment. The theory also enables the application of the fuzzy domain in mathematics and programming. A fuzzy set is a class of objects with a continuum of membership degrees, characterized by a membership function which assigns a membership grade ranging between zero and one to each object (Kahraman *et al.*, 2000).

In classical set theory, an object is either a member of a set or excluded from it. Thus, in conventional dual logic, a statement can only be either true or false. In reality, however, human cognition, perception and judgment involve approximate and vague reasoning, and cannot be modelled adequately by classical set theory. Fuzzy sets were introduced by Zadeh (1965) as a method of handling vagueness or uncertainty, particularly linguistic variables. Fuzzy sets consider the gray area of data, rather than considering membership of a set to be simply true or false. In other words, fuzzy sets allow partial membership of a set. The following seven steps, based on the technique introduced by Chen (1997), are used for this research purpose in ranking airlines service quality factors:

Step one:

Consider Fuzzy Decision Matrix of respondents' idea as if follows, where i stands for the number of factors (performance indicators) and j stands for the number of respondents. Also,

\tilde{X}_{ij} stands for the score assigned by respondent number i for factor j . On the other hand, \tilde{W}_{ij} is the importance (weight) of each respondent's ideas. It must be added that, because all the

respondents are considered to have the same weight, \tilde{W}_{ij} will be defined as $\tilde{W}_j = (1,1,1) \forall j \in n$.

$$\tilde{D} = \begin{bmatrix} \tilde{X}_{11} & \tilde{X}_{12} & \dots & \tilde{X}_{1n} \\ \tilde{X}_{21} & \tilde{X}_{22} & \dots & \tilde{X}_{2n} \\ \vdots & \vdots & \ddots & \vdots \\ \tilde{X}_{m1} & \tilde{X}_{m2} & \dots & \tilde{X}_{mn} \end{bmatrix}$$

$$\tilde{X} = (a_{ij}, b_{ij}, c_{ij})$$

$$\tilde{W} = [w_1, w_2, \dots, w_n]$$

Step two:

This step includes neutralizing the weight of decision matrix and generating fuzzy un-weighted matrix (\tilde{R}). To generate \tilde{R} , either of the following relations can be applied:

Relation 1:

$$\tilde{R} = \left[\tilde{r}_{ij} \right]_{m \times n} \quad \tilde{r}_{ij} = \left(\frac{a_{ij}}{c_j^*}, \frac{b_{ij}}{c_j^*}, \frac{c_{ij}}{c_j^*} \right)$$

, where:

$$c_j^* = \max_i c_{ij}$$

Relation 2:

$$\tilde{r}_{ij} = \left(\frac{a_j^-}{c_{ij}}, \frac{a_j^-}{b_{ij}}, \frac{ca_j^-}{c_{ij}} \right)$$

, where

$$a_j^- = \min_i a_{ij}$$

Step three:

This step includes generating fuzzy un-weighted matrix (\tilde{V}), while having \tilde{W}_{ij} as an input for the algorithm.

$$\tilde{V} = \left[\tilde{v}_{ij} \right]_{m \times n} \quad i = 1, 2, \dots, m, \quad j = 1, 2, \dots, n,$$

$$\tilde{v}_{ij} = \tilde{r}_{ij} \cdot w_j$$

Step four:

Determine positive ideal ($(FPIS, A^+)$) and negative ideal ($(FNIS, A^-)$) for the factors:

$$A^+ = (\tilde{v}_1^*, \tilde{v}_2^*, \dots, \tilde{v}_n^*)$$

$$A^- = (\tilde{v}_1^-, \tilde{v}_2^-, \dots, \tilde{v}_n^-)$$

In this research, the positive and negative ideas introduced by Chen (1997) are used. Therefore,

$$\tilde{v}_j^* = (1, 1, 1)$$

$$\tilde{v}_j^- = (0, 0, 0)$$

Step five:

In this step, we calculate the sum of distances from positive and negative ideas for each factor:

For fuzzy numbers such as A and B, the difference between A and B shown as $D(A, B)$, is determined using the following formula:

$$\tilde{A} = (a_1, b_1, c_1) \quad \tilde{B} = (a_2, b_2, c_2)$$

$$D(A, B) = \sqrt[3]{\frac{1}{3}[(a_2 - a_1)^2 + (b_2 - b_1)^2 + (c_2 - c_1)^2]}$$

Therefore, the difference of each factor from positive and negative ideals is calculated:

$$d_i^* = \frac{\sum_{j=1}^n d(\tilde{v}_{ij} - \tilde{v}_j^*)}{n} \quad i = 1, 2, \dots, m$$

$$d_i^- = \frac{\sum_{j=1}^n d(\tilde{v}_{ij} - \tilde{v}_j^-)}{n} \quad i = 1, 2, \dots, m$$

Step six:

The adjacency of each factor to positive ideal is calculated as the following:

$$CC_i = \frac{d_i^-}{d_i^* + d_i^-} \quad i = 1, 2, \dots, m$$

Step seven:

This is the final step where we rank factors in a descending order of CC_i . Therefore the higher CC_i go to top.

Findings

The findings of this research shows that “students’ satisfaction from education”, “academic staff’s satisfaction grade”, “ratio of students to academic staff in master and PhD degree programs”, “students’ satisfaction grade”, “increase in students’ tendency to enter school” and “level of performance-based culture availability” are considered as the most important performance indicators of educational balanced scorecard in the perspective of Iranians. Interestingly, “students’ satisfaction level from school’s internal processes”, “value of raised services and aids from outside university sources in Rials” and “students’ satisfaction level from school’s administrative staff performance” have been selected as the least important performance indicator by respondents. Table 4 shows the rankings of the performance indicators.

Table 4: Ranking performance indicators of educational balanced scorecard

| Rank | Factor | d_i^* | d_i^- | Ci |
|------|--|---------|---------|-------|
| 1 | Students’ satisfaction from education | 0.102 | 0.927 | 0.901 |
| 2 | Academic staff’s satisfaction grade | 0.111 | 0.916 | 0.892 |
| 3 | Ratio of students to academic staff in master and PhD degree programs | 0.129 | 0.897 | 0.874 |
| 4 | Students’ satisfaction grade | 0.131 | 0.894 | 0.872 |
| 5 | Increase in students’ tendency to enter school | 0.161 | 0.862 | 0.843 |
| 6 | Level of performance-based culture availability | 0.223 | 0.803 | 0.783 |
| 7 | Ratio of students to academic staff in bachelor degree programs | 0.198 | 0.598 | 0.752 |
| 8 | University’s position in national and international rankings | 0.206 | 0.589 | 0.741 |
| 9 | Average no. of papers by academic staff published in ISI journals per year | 0.208 | 0.585 | 0.738 |
| 10 | Average cycle for renewing educational facilities and equipments | 0.208 | 0.583 | 0.737 |
| 11 | Time cycle for up-to-dating the computer and IT equipments of the school | 0.214 | 0.579 | 0.730 |
| 12 | Average no. of papers by academic staff published in refereed research journals per year | 0.216 | 0.578 | 0.728 |
| 13 | Number of complaints made per month | 0.220 | 0.574 | 0.723 |
| 14 | Average usage of library services | 0.234 | 0.558 | 0.704 |
| 15 | Ratio of using office automation in processes | 0.237 | 0.556 | 0.701 |
| 16 | Average no. of papers by academic staff published in conferences per year | 0.247 | 0.556 | 0.692 |
| 17 | No. of International students enrolled in comparison to total no. students at school | 0.247 | 0.547 | 0.689 |
| 18 | No. of online programs offered by school | 0.247 | 0.543 | 0.687 |
| 19 | Ratio of using computer in processing and keeping documents | 0.252 | 0.540 | 0.682 |
| 20 | Value of contracts with industry per year in Rials | 0.255 | 0.539 | 0.679 |

| | | | | |
|----|---|-------|-------|-------|
| 21 | Average life cycle of facilities and equipments | 0.269 | 0.521 | 0.659 |
| 22 | Annual revenue from tuition | 0.271 | 0.520 | 0.658 |
| 23 | Total fund raised in Rials | 0.272 | 0.521 | 0.657 |
| 24 | Average cost of educational staff | 0.273 | 0.522 | 0.656 |
| 25 | Average cost of administrative staff | 0.273 | 0.519 | 0.655 |
| 26 | Students' satisfaction level from school's internal processes | 0.278 | 0.519 | 0.651 |
| 27 | Value of raised services and aids from outside university sources in Rials | 0.278 | 0.515 | 0.650 |
| 28 | Students' satisfaction level from school's administrative staff performance | 0.312 | 0.481 | 0.606 |

Conclusion

Universities world-over are facing the challenge of being centers of excellence for teaching as well as research. On one hand universities are increasingly being required to teach ever increasing number of students in increasing numbers of specializations and disciplines, and on the other they are being asked to pay more attention to quality of teaching and educational programs (Smeby, 2003). This again indicates at the requirement to re-look at the ways institutions of higher learning are to be managed.

One of the most successful performance measurement which has been widely implemented by various organizations during the previous years is Balanced Scorecard. It measures organization's performance within four perspectives based on several defined performance indicators. Although these indicators are inter-connected to reach to organizational vision and mission, still BSC fails to provide any relationship between the importance of each of these indicators. Therefore, this paper tried to fill this gap by studying and prioritizing the performance indicators of balanced scorecard model implemented in an Iranian university.

This explorative study gives a valuable first insight into the importance of each performance indicator according to Iranian university professors and reveals the rank of each single performance indicator in comparison to others.

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CHARACTERISTICS OF ENTREPRENEURS: A COMPARATIVE STUDY OF SMALL SCALE ENTREPRENEURS OF SRILANKAN AND BANGLADESH

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Abstract

People are the most valuable resource within any country. There appears to be a strong linkage between the training, attitudes and goals of people and the level of economic growth within a country. An essential ingredient in the economic growth of any country is the key individual who promotes change and development, these persons may be called entrepreneurs. The Entrepreneurs are playing a major role in accelerating the pace of economic development the world over by their innovative and creative approach to the process of production and product launching in the market. They have thus helped to guide a new economic order by perception of new opportunities and converting them into profitable ventures. Hence various studies have been done on the above theme, but no studies have been conducted in SriLankan and Bangladesh perspectives, especially in Small Scale Entrepreneurs. Present study is initiated Characteristics of Entrepreneur, as a comparative study of Small Scale Entrepreneurs of SriLankan and Bangladesh with the samples of fifty (50). Factor analysis shows that SriLankan entrepreneurs have characteristics such as seeking opportunity, persistence, commitment to work contract, demand for work quality and efficiency, risk taking, visionary, similarly Bangladeshi entrepreneurs also have above characteristics except visionary.

Keywords: *Entrepreneurs, Characteristics of Entrepreneurs, Entrepreneurship, Economic Growth, Industrial development*

1.0 Background of the Study

The Products or Services are produced to satisfy human needs. While considering the fact the most of the commodities produced, services rendered, the way they are performed through Small Business Enterprises, the field of small business drew attention of the researcher¹. But limited opportunities for jobs in unemployment and scarcity of capital are some factors, which prevail, here searching for the best way to gain success in these factors. Therefore, Small Business Entrepreneurs are given prominence to accomplish a product or service or to undertake an enterprise successfully.

Entrepreneurship is a process undertaken by an entrepreneur to augment his business interests. It is an exercise involving innovation and creativity that will go towards establishing his or her enterprise. Entrepreneurship is a compose skill, the resultant of a mix of many qualities and traits, which include tangible factors as imagination, readiness to take risks, ability to bring together and put to use other factors of production, capital, labour and land as well as other intangible factors such as managerial skill, ability to mobilize scientific and technological advances etc.

In practice, entrepreneurs have historically altered the direction of national economies, industries, or markets. They have invented new products and developed organizations and the means of production to bring them to market according to their characteristics. The characteristics of an entrepreneur differ from entrepreneur to entrepreneur, even though, the characteristics of an entrepreneur that contribute to success are the result of his achievement motivation.

¹ Ministry of Finance and Planning, (2005). "Statistical Abstract of the Democratic Socialist Republic of SriLanka", Department of census and Statistics.pp 7-20.

1.1 Review of Literature

1.1.1 The term Entrepreneur

An Entrepreneur is any person who possesses the qualities and uses them in setting up and running an enterprise. Entrepreneurs are enterprise builders, they perceive new business opportunities, organize business where none existed before, direct these businesses by using their own and borrowed capital, take the associated risks, and enjoy profit as rewards for their efforts.

The origin of the word “Entrepreneur” may be traced back to sixteenth century in French language. In the early sixteenth century it was applied to those who were engaged in military expeditions. Kilby (1971) pointed out the word “entrepreneur” was first used to refer to economic activities in the early eighteenth century by Richard Cantillon. The entrepreneur is a critical factor in the socio-economic change. He is the key person who envisages new opportunities, new techniques, and new lines of production, new products and co-ordinates.

The entrepreneur is rarely a master of the management skills, and yet is usually directly responsible for all aspects of business. Often he or she has to be the general manager, production manager, purchasing manager, personnel manager, controller and researcher for the business all rolled into at least during its early years. The entrepreneur therefore has to have an understanding of marketing, quality control, finance, banking, commercial law, government regulations and procedures and human relations as each of them has a vital bearing on the health of the enterprise. There are various differences in the views of scholars in defining an entrepreneur. Generally, a person who takes risk or has the capability of taking risk for developing or establishing new ventures is an entrepreneur. An entrepreneur creates something novel by the work done by him/her. This creation means creation of new opportunities or new utilities for his /her own development and for the welfare of human beings.

The term “entrepreneur” is defined in a variety of ways yet no consensus has been arrived at on the precise skills abilities that make a person a successful entrepreneur. The concept of entrepreneur varies from country to country as well as from period to period and the level of economic development thoughts and perceptions. A review of research done in different disciplines over the years would improve our understanding of the concept of entrepreneur. Entrepreneur is a self-employed person, who are not born but made under congenial environment. The quality and competence of every entrepreneur are requisites for the successful operation of the small industrial venture. Small industry, involving relatively simple technology and small investment, producing goods mostly for domestic consumption is capable of generating larger employment opportunities. Ever since the seminal work of Schumpeter (1934) the entrepreneurship has been regarded as a major topic in theory and practice of economic growth and development. The entrepreneurship has been defined as consisting of two criteria. The first involves the state of knowledge and is the ability of economic agents to recognize economic opportunities that can only or best be realized through the creation of a new enterprise to appropriate the economic opportunities that can only or best be realized through the creation of a new enterprise to appropriate the economic value of that knowledge.

1.1.2 Characteristics of Entrepreneurs

Characteristics of successful entrepreneurs have also been well documented. While there is no agreement among the scholars as to the number and labels of these characteristics, they in general include desire for responsibility, preference for moderate risk, and confidence

in personal success, desire for immediate feedback, high level of energy, sufficient emotional stability, objective approach to interpersonal relationships, low need for status, and a comprehensive awareness of total environment (Olm and Eddy, 1985; Zimmerer and Scarborough, 1988; and ILO, 1994). Feather (1988) only refers to successful owner/managers as those who have entrepreneurial characteristics. According to Cunningham and Lischeron, (1991) successful owner/managers have been identified with a personal value type referred as entrepreneurial.

They have also argued that entrepreneurs place high value on ambition, achievement, reliability, responsibility, hard work, competence, optimism, innovation, aggressiveness, honesty, creativity, social recognition and growth (Kotey and Meredith, 1997).

Rotter (1966) refers to an entrepreneur as a person with a high internal locus of control higher internal locus of control shows that the owners are responsible for their own actions. Schumpeter (1950) an entrepreneur is a person who is willing and able to convert a new idea or invention into a successful innovation.

Bird (1992) sees entrepreneurs as mercurial, that is, prone to insights, brainstorm, deceptions, ingeniousness and resourcefulness. They are cunning, opportunistic, creative, and unsentimental. According to Cole (1959) there are four types of entrepreneur: the innovator, the calculating inventor, the over-optimistic promoter, and the organization builder. These types are not related to the personality but to the type of opportunity the entrepreneur faces. Collins and Moore (1970) studied 150 entrepreneurs and concluded that they are tough, pragmatic people driven by needs of independence and achievement. They seldom are willing to submit to authority.

According to Say (1803) was the first among the classical economics to write about entrepreneurship to him, an entrepreneur is the economic agent who unites all means of production, the labour force to force of the one and the capital or Land of the others and who finds in the value of the products which results from their employment, the reconstitution of the entire capital that the utilize and values of the wages, the interest and the rent which he pays as well as profit belonging to himself. One of the noted economists of the 19th century, Schumpeter (1934) is of the view that an entrepreneur is a catalytic agent of change. He/She is in a position to transform the various inputs like physical, natural and human resources into produce channels.

According to Drucker (1994) defined an entrepreneur as one who always searches for change, responds to it and exploits it as an opportunity. Innovation is the specific tools of entrepreneurship the means by which they exploit change as an opportunity for a different business / service.

Shapero (1975) pointed out an entrepreneur takes initiative; organize some social – economic mechanisms. But he is the person who knows the art of changing the production function for using the economic potential of various factors of production.

According to Hisrich (1989) an entrepreneur is the process of creating something different with value by devoting the necessary time and effort, assuming the accompanying financial psychological and social risks and receiving the results rewarded of monetary and personal satisfaction.

The characteristics of achievement motivated persons as identified by McClelland (1961). Successful entrepreneur must be a person with technical competence, initiative, good judgment, intelligence, leadership qualities, self – confidence, energy, attitude, creativeness, fairness, honesty, tactfulness and emotional stability.

Timmons (1994) analysis of more than 50 studies found a consensus around six general characteristics of entrepreneurs : (1) commitment and determinations ; (2) leadership (3) opportunity obsession; (4) tolerance of risk, ambiguity and uncertainty; (5) creativity, self – reliance and ability to adapt; and (6) motivation to excel.

A related stream of research examines how individual demographic and cultural backgrounds affect the chances that a person will become an entrepreneur and be successful at the task. Binachi (1993) review indicates these characteristics include (1) being an offspring of self-employed parents; (2) being fired from more than one job; (3) being an immigrant or a child of immigrants; (4) previous employment in a firm with more than 100 people; (5) being the oldest child in the family and being a college graduate. Hashim, Wafa, and Suliman (1999) have proven empirically that entrepreneurial characteristic of the owner / managers are closely related to the success of the firm. A study specific in this industry is very important because the characteristics of the owner/manager have been shown to be influenced by industry practices (Box, White, and Barr, 1993).

Entrepreneurial success (ES) depends on the characteristics of personal profile and motivational factors of the entrepreneurs that lead to superior performance of the entrepreneur (McClelland, 1985). Murthy, Shekhar and Rao (1986) found that entrepreneurs are motivated to start a business because of the factors like ambitious factors, compelling factors and facilitating factors. Whatever may be the reason, it can be said that in most of the times of the history of human civilization, there were entrepreneurs who did independent business and this trend of history still continues. For the last few decades in all over the world, entrepreneurs are regarded as value adding people to the society.

Being a high-achieving entrepreneur is not that easy. An entrepreneur should have several special characteristics that help them to become a successful businessman. An entrepreneur should be a risk taker; he/she should be innovative, self-confident, goal setter, hard worker, and accountable (Siropolis, 1997). In other words, entrepreneurs must be persistent, self-confident, creative, and optimistic and independent minded (Holt, 1992). They are realistic about working hard and driving toward measurable results, tend to have superior conceptual abilities and are generally emotionally stable (Welsh and White, 1981).

In an on Entrepreneurship conducted at the east-west center, Honolulu, in 1977 a list of characteristics and traits of the entrepreneurs was prepared (Meredith, Nelson, and Neck, 1982). This list says an entrepreneur should have characteristics like self-confidence, task-result orientation, and risk taking, leadership, and originality and future orientation. It is not necessary that an entrepreneur should have all these characteristics at a very high rate. But the more a person has these qualities, the greater chance there is for him/her to become an entrepreneur (Meredith, Nelson, and Neck, 1982) because he/she will be able to perform the 'entrepreneurial functions' properly because of these traits.

Khanka (1999) says, the three broad categories of an entrepreneur's function: Risk taking, organization and innovation. Hisrich and Peters (1998) characteristics entrepreneurship as a process of creating something new and assuming the risks and rewards. Kourilsky (1995) defined entrepreneurship education as "opportunity recognition, marshalling of resources in the presence of risk and building a business venture". In terms of the individual entrepreneur, research suggests that these people do have certain characteristics and character traits that make them stand out (Burns, 2001).

These traits are well documented in the literature on the subject and include risk taking and the need for achievement (McClelland, 1961), locus of control (Rotter, 1966) and the desire for autonomy and deviancy (De vries, 1977). Islam, Mamun and Jahiruddin (1999) identified some critical factors for the small entrepreneurs of Bangladesh like risk taking, flexible persistent, action, achievement motivation, self-confidence, knowledge of the business for their success.

Timmons (1978), in a review of literature, has identified 14 characteristics of an entrepreneur. These are: (1) drive and energy, (2) self-confidence (3) long-term involvement, (4) money as a setting, (7) moderate risk-taker, (8) dealing with failure, (9) use

of feed – back, (10) taking initiative and seeking personal responsibilities, (11) use of resources, (12) competing against self imposed standards, (13) internal locus of control, and (14) tolerance of ambiguity and uncertainty.

Based on the above literature, various studies have been done on this area, but a detailed study has not yet been conducted in SriLankan and Bangladesh context, especially in Small scale. Hence the present study is made on “Characteristics of Entrepreneurs” a comparative study of small scale entrepreneurs of SriLankan and Bangladeshi.

1.2 Objectives of the Study

The prime objective of the study is to find out the entrepreneur characteristics of the SriLankan and Bangladeshi small-scale entrepreneurs to achieve the main objective the study focuses on the following sub objectives.

1. To find out the Demographic characteristics of small-scale entrepreneurs of SriLankan and Bangladeshi
2. To find out the psychological characteristics of small scale of entrepreneurs of SriLankan and Bangladeshi

1.3 Hypothesis

The following hypotheses are taken for the study.

H₀: There are no differences between behavioral characteristics and psychological characteristics of small-scale entrepreneurs of Bangladeshi and SriLankan.

H₁: There are differences between behavioral characteristics and psychological characteristics of small-scale entrepreneurs of Bangladeshi and SriLankan.

1.4 Scope of the Study

The study also included a survey of the small-scale entrepreneurs in order to measure the characteristics. Due to the paucity of time and fund at the disposal of the researcher this study was confined to fifty (50) samples of small-scale entrepreneurs of SriLankan and Bangladeshi. The enterprises, which were formed during the last 10 years, were included in the study.

1.5 Methodology and Sampling design

This study is an empirical study, based on the primary data. Considering the nature of the present study, a combination of structured questionnaire was used in order to collect relevant information from a sample of 50 small scale entrepreneurs. A total of 50 small scale entrepreneurs were randomly selected from a list of registered firms in Bangladesh and SriLanka by Bangladesh Readymade Garments Manufacturing Association (BRGMA) and Industrial Development Board of SriLanka (IDB) respectively, the sample for this study is small scale entrepreneurs of Bangladesh and SriLanka. Random sampling method is used to select the entrepreneurs. Ultimately the present study will be made with the samples of fifty (50). A well known statistical package SPSS (Statistical Package for Social Sciences) version 13.0 was used in order to analyze the data.

1.6 Data Collection

Both primary and secondary data are used for the study. Primary data are collected through the questionnaire with Case Study method, which was designed on the basis of objectives and hypothesis. The Questionnaire comprised two parts, part one consisted profile of the enterprise and entrepreneurs, which are consisted eight questions, part two consisted characteristics of the entrepreneurs, which are included eighty-nine questions under twenty characteristics. Secondary data were collected through the books, journals and etc...

1.7 Analysis of Results

According to the Table 01 higher percentages that are 36.0% and 56.0% indicate 41-50 years age group respectively in SriLankan and Bangladesh entrepreneurs'. At the same time Table 02 shows that, lower percentage 4.0% refer the below 20 years age group in both country entrepreneurs. And also highest percentage of the entrepreneurs that is 48.0% have the postgraduate qualification and second highest percentage of the entrepreneurs that is 44.0% belongs to the undergraduate qualifications. The interesting findings are the percentage of the post graduate qualification (Graduate) of the entrepreneurs (40.0%, 48.0%) have the highest qualifications of the entrepreneurs in both countries. The responses of the subject to the second part of the questionnaire were factor analysed using principal component method. In the factor analysis, orthogonal varimax rotation was used because it minimises the number of variables which have high loading on any one given factor, resulting easier identification of each variable with a single factor (Rennie,1997). Only items with factor loadings of 0.40 and above were considered significant interpreting the factors. Table 3 shows that results of the factor analysis in terms of the factor names, the variables loading on each factor and the variance explained by each factor. Twenty factors were produced. In selecting the number of factorial groups to be extracted, the Kaiser criterion was adopted. According to Kaiser criterion all factors with eigenvalues less than 1.0 should be dropped from further analysis. In the present analysis, following this procedure led to SriLankan pointof view, the fourteen factors being dropped, and six factors, each with six factors greater than 1.00 being retained and Bangladeshi point of view, the fifteen factors being dropped, and five factors greater than 1.00 being retained. As Table 3 shows, these factors accounted for 79.826% and 79.882% of the total variance for SriLankan and Bangladesh respectively.

1.8 Discussion of Results

"The primary motivations of the entrepreneur bear upon not only the decision to start but also upon the decision about how to manage, including whether or not to grow the firm aggressively"(Cooper,1993). The growth of the entrepreneurship is therefore of importance to governments,like those in Developing countries, that are seeking to optimize the employment opportunities associated with an entrepreneurship sector in which "success" is the norm.

According to the factor analysis SriLankan entrepreneurs have characteristics such as seeking opportunity, persistence, commitment to work contract, demand for work quality and efficiency, risk taking, visionary, similarly Bangladeshi entrepreneurs also have above characteristics except visionary. Hence, Null hypothesis accepted and also alternative hypothesis rejected. Finally, it can be concluded, SriLankan and Bangladesh entrepreneurs have similar characteristics.

1.9 Suggestions

In today's world entrepreneurs tend to play a vital role. The economic development of a country largely depends on their contribution. Entrepreneurs change the market, bring new things into existence, and introduce new ways of doing things. They bring wealth, prosperity, employment and change to the society in which they are part of themselves. Entrepreneurs have changed much during the decades and century's people's taste, fashion, and their way of living have been affected by entrepreneur's spirit. According to the research findings strong need to focus future research on the development of an understanding of the individual entrepreneurs' characteristics and future goals to give insight into her or his future behavior and, ultimately, to gain understanding of one of the principal determinants of enterprise success and failure.

1.10 Limitations of the Study

There were some limitations of this study. The main limitation of the study was sample size. Due to the paucity of time and fund at the disposal of the researcher this study was confined to fifty (50) samples. Hence, future research is also encouraged to overcome the concerned limitations of this study.

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Annexure

Table 1: Frequency and Proportion of Age of the entrepreneurs

| Age group | SriLankan Entrepreneurs' | | | Bangladesh Entrepreneurs' | | |
|-----------|--------------------------|------------|-----------------------|---------------------------|------------|-----------------------|
| | Frequency | Percentage | Cumulative Percentage | Frequency | Percentage | Cumulative Percentage |
| below 20 | 1 | 4.0 | 4.0 | 1 | 4.0 | 4.0 |
| 21-30 | 3 | 12.0 | 16.0 | 2 | 8.0 | 12.0 |
| 31-40 | 8 | 32.0 | 48.0 | 5 | 20.0 | 32.0 |
| 41-50 | 9 | 36.0 | 84.0 | 14 | 56.0 | 88.0 |
| over 60 | 4 | 16.0 | 100.0 | 3 | 12.0 | 100.0 |

Table 2: Educational qualification of entrepreneurs

| Educational Qualification | SriLankan Entrepreneurs' | | | Bangladesh Entrepreneurs' | | |
|----------------------------|--------------------------|------------|-----------------------|---------------------------|------------|-----------------------|
| | Frequency | Percentage | Cumulative Percentage | Frequency | Percentage | Cumulative Percentage |
| below G.C.E O/L S.S.C | 0 | 0 | 0 | 0 | 0 | 0 |
| G.C.E O/L/ S.S.C | 1 | 4.0 | 4.0 | 1 | 4.0 | 4.0 |
| H.S.C/ A/L | 1 | 4.0 | 8.0 | 2 | 4.0 | 12.0 |
| Technical diploma | 4 | 16.0 | 24.0 | 5 | 0 | 32.0 |
| Undergraduates | 9 | 36.0 | 60.0 | 14 | 44.0 | 88.0 |
| Post Graduates / Graduates | 10 | 40.0 | 100.0 | 3 | 48.0 | 100.0 |

Table 3: Factors identified, Percentage of Variance

| Factor No | Name of the Factors | SriLankan entrepreneurs | | Bangladesh entrepreneurs | |
|--------------------------|--|-------------------------|------------------------|--------------------------|------------------------|
| | | Eigen value | Variance in Percentage | Eigen value | Variance in Percentage |
| 01 | Seeking opportunity | 8.130 | 40.648 | 9.924 | 49.621 |
| 02 | Persistence | 2.197 | 10.986 | 2.143 | 10.714 |
| 03 | Commitment to work contract | 1.882 | 9.410 | 1.663 | 8.315 |
| 04 | Demand for work quality and efficiency | 1.454 | 7.269 | 1.236 | 6.179 |
| 05 | Risk taking | 1.250 | 6.252 | 1.011 | 5.053 |
| 06 | Visionary | 1.052 | 5.261 | 0.854 | 4.272 |
| Total Variance explained | | | 79.826 | | 79.882 |

THE IMPACTS OF ICT AND GLOBALIZATION ON TRADE IN SERVICES

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Dr. İbrahim ARSLAN**

Abstract

The services sector nowadays has expanded in scope beyond the traditional activities in finance, transport, travel and telecommunication and audio-visual services to a host of professional services, such as software and information services, engineering and legal services, e-commerce and other internet-based service offerings. At the post second world war period, the growth of services have shown a dramatic increase in most of the developed countries of the world. This growth was driven largely by advances in information technology and telecommunications, and has created new sectors. Some of these are electronic communication, scanning information, finance, e-trade, etc. The increase in the usage of personel computers and internet have caused these sectors to develop by forming new subsectors. Computerized storage of data and the remote delivery of services by means of electronic communication, have helped to increase tradability of services. Investments towards trade in services will be driving force in coming years to increase employment and development of economies. In addition, these developments will pass through among countries.

Turkey as a developing country has a good performance in services sector. This performance has indications of being one of the developed countries of the world for Turkey. The purpose of this study is to show the effects of ICT and globalisation on service trade and evaluate the position of Turkey.

Keywords: *ICT and trade, World trade in services, global competition.*

1. Introduction

In the global economy, a series of changes has increased the importance of developments in internet and communication technologies (ICT) . Development in ICT after 1990s have caused service mobility composing an indispensable infrastructure. The difference between trade in goods and services have been disappeared. Services look for an infrastructure to mobilize. Telecommunication networks and widening internet made it possible for some service sectors, such as education, health, engeneering, banking and entertainment, etc. to be tradable. Thus, people will have the knowledge about the quality and price of the goods and services in any country in the world.

This process is picking up speed in last years making the world a place where standardized goods and services are put into use by means of decreasing prices and increasing the quality and efficiency. The purpose of this study is to show the importance of ICT in service trade, and how it could be accomplished to make services globally available and marketable.

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2. A Brief Survey of the Related Literature

Basic theory suggests that after a trade reform, workers in industries which lack a comparative advantage will lose out, while those based in sectors with a comparative advantage will gain. The opening process brings more opportunities to access comparative intermediate goods and capital goods that embody better technologies. It also stimulates productivity, better resource allocation, and exports, while giving local producers and consumers access to less expensive and higher quality goods from abroad (Yüceol, 2007: 16). In this process where formation of new standards and developments in technology has improved the supply chains between consumers and distributors. Acceleration of knowledge sharing has lessened the time of learning and specialization as well. Developments in IT has provided widening of markets and increase the limits of the capacity. Product life curves are so short in innovative markets means that markets continuously live the growing phase instead of deterioration and stagnation (Bayraktutan, 2003). Growing phase of the market and the risk of new entrances increases the motivation of innovation of existing firms (Yılmaz, 2003: 33).

Recent literature surveys document the large potential gains from liberalization of trade in communications, finance, transport, and other services (Hoekman, 2006). Moreover, even exploiting the opportunities arising from liberalization of trade in goods will require better services (Hoekman, and Matto, 2007: 399-418). The growth of the service sectors in advanced economies, as measured by rates of change in sales, value-added, or employment, has exceeded that of the goods-producing industries for several decades. Furthermore, for at least the first half of the 1980s, the number of jobs in goods producing industries in Canada and the United States actually declined: all of the net increase in employment during this period was accounted for by service industries (Stabler, and Howe, 1993: 30).

The liberalization of trade in services could also have impact on the international trade of goods. International trade in goods requires inputs from several service industries, such as transportation, insurance, and finance in order to complete and facilitate international transactions. Restrictions on the ability of national service providers to provide these services across borders and within foreign countries create additional costs that might limit the international flow of trade in goods. Elimination of these restrictions, then, should provide a boost to the international trade of goods. There are not empirical measures of the effects of trade in services on trade in goods (Blyde, and Sinyavskaya, 2007: 566-583).

It is almost a universal assumption in the trade literature that the items being traded are goods that can be shipped across national borders. The lack of attention to trade in services is understandable given the intangible nature of many services that prevents them from being traded across national borders like goods. The apathy about service trade has changed, however. The past decade has seen a growing interest in service trade among a wide spectrum of people from the business, academic, and government sectors. Nowhere is this overdue recognition of service trade more resounding than the inclusion of services in the World Trade Organization (WTO) in 1994, under the General Agreement of Trade in Services (GATS) (Wong, wu, and Zhang, 2006: 148-168).

3. Trade in Services Under Globalisation

It is very difficult to specify a time for the beginning of globalization. Some views accept the civilization efforts of human being as a starting date for globalization. Some accept it as a beginning of modern age and some accept it as the mids of 1800s and some accept as last 1950s or 1970s. However, as of the early 1980s the concepts of privatization, market economy, financial liberalization, integration with the world had more concern comperatively

(Bayraktutan, 2007: 162). These changings have converged developing and developed countries to each other. On the other hand, with the activities of the industrial firms, rapid market changing, developments in product and production Technologies, and competition, globalisation have a pronounced affair in 1980s (DPT, 1995: 12).

Table-1: Import-Export Share of Selected Countries in Services

| Number | Exporter | Value | Share | Annual Change | Place in the World | Importers | Value | Share | Annual Change |
|--------|-------------------|-------|-------|---------------|--------------------|-------------------|-------|-------|---------------|
| 1 | USA | 282,5 | 16 | 4 | 1 | USA | 218,2 | 12,5 | 6 |
| 2 | UK | 129,5 | 7,3 | 5 | 2 | Almanya | 167 | 9,6 | 12 |
| 3 | Germany | 111,7 | 6,3 | 12 | 3 | UK | 112,4 | 6,4 | 11 |
| 4 | France | 98 | 5,6 | 14 | 4 | Japon | 109,7 | 6,3 | 3 |
| 5 | Spain | 76,4 | 4,3 | 23 | 5 | France | 81,6 | 4,7 | 20 |
| 6 | Italy | 72,8 | 4,1 | 23 | 6 | Italy | 74,1 | 4,3 | 21 |
| 7 | Japon * | 70,2 | 4 | 8 | 7 | Holland | 66,2 | 3,8 | 17 |
| 8 | Holland | 64,1 | 3,6 | 18 | 8 | China | 53,8 | 3,1 | ... |
| 9 | China | 44,5 | 2,5 | ... | 9 | İrland | 48,5 | 2,8 | 20 |
| 10 | Hong Kong, China | 43,2 | 2,5 | 0 | 10 | Canada | 47,8 | 2,7 | 14 |
| 11 | Belgium | 41,7 | 2,4 | 17 | 11 | Spain | 46,1 | 2,6 | 22 |
| 12 | Austria | 41,4 | 2,3 | 19 | 12 | Belgium | 41,4 | 2,4 | 17 |
| 13 | Canada | 39,2 | 2,2 | 8 | 13 | Austria | 40,6 | 2,3 | 18 |
| 14 | İrland | 35,3 | 2 | 26 | 14 | Republic of Korea | 38,7 | 2,2 | 10 |
| 15 | Switzerland | 32,7 | 1,9 | 17 | 15 | Sweden | 29,6 | 1,7 | 25 |
| 16 | Danmark | 32,6 | 1,9 | 20 | 16 | Danmark | 29,1 | 1,7 | 16 |
| 17 | Republic of Korea | 31,2 | 1,8 | 15 | 17 | Singapore | 27,2 | 1,6 | 0 |
| 18 | Sweden | 31 | 1,8 | 32 | 18 | Russia | 26,7 | 1,5 | 13 |
| 19 | Singapore | 30,4 | 1,7 | 3 | 19 | Taywan, China | 25,5 | 1,5 | 7 |
| 20 | India | 24,9 | 1,4 | ... | 20 | Hong Kong, China | 23,5 | 1,3 | -5 |
| 21 | Greece | 24,4 | 1,4 | 21 | 21 | Australia | 21,1 | 1,2 | 19 |
| 22 | Luksemburg | 23,8 | 1,4 | 18 | 22 | Switzerland | 19,9 | 1,1 | 17 |
| 23 | Taiwan, China | 23 | 1,3 | 7 | 23 | India | 19,7 | 1,1 | ... |
| 24 | Norvey | 22,2 | 1,3 | 16 | 24 | Norvey | 19,5 | 1,1 | 18 |
| 25 | Australia | 20,6 | 1,2 | 18 | 25 | Tayland | 18,1 | 1 | 9 |
| 26 | Turkey | 17,3 | 1 | 17 | 26 | Indonesia | 17,7 | 1 | ... |
| 27 | Russia | 15,9 | 0,9 | 18 | 27 | Mexico | 17,4 | 1 | 2 |
| 28 | Tayland | 15,5 | 0,9 | 2 | 28 | Malesia | 16,4 | 0,9 | 1 |
| 29 | Malesia | 12,8 | 0,7 | -13 | 29 | Luksemburg | 15,8 | 0,9 | 16 |
| 30 | Mexico | 12,5 | 0,7 | 0 | 30 | Brasil | 14,6 | 0,8 | 7 |

Source: OECD (1999). Numbers of Turkey was calculated from SSI Foreign Trade Statistics.

In the beginnings of 1990s this process has ended with the collapse of former eastern block countries. These countries where planned economy was dominant has converged to west countries in time. Communism has left the place to democracy and market economy. In this process, Uruguay Round in the frame of GATT was one of the most striking development for globalization in 15 December 1993 with the participation of 117 countries

(DPT,1995). In April 15, 1994, "Last Agreement" was signed in Morocco, and it has sooner come into force. This agreement includes the ignorance of export subsidies, anti-dumping applications, dissolution of technical barriers in trade. World Trade Organization is one of the most important developments for applications of these results. Another important affair about economic globalisation is Multilateral Agreement on Investments (MAI). According to MAI, any firm having activities internationally can have business in a country like a firm of that country who sign the agreement.

From the beginning of 1960s, some countries have shown an increase in their economic and commercial linkages, such as Japan, USA and developed European countries. These linkages have accelerated the integration to commerce, finance and production process for developing countries (Sachs, 1998). ICT increases international competition which is brought by globalization which necessitates structural changes in the economies of the developing countries. Integration of developing countries with the global economy provides a support for the economic wealth of these countries in the long run (World Bank, 1995: 2; Ouattara, 1997: 1; Kutlu, 1998: 365).

Developing technologies in our age has brought different innovations in each field and these innovations have effected each country differently. Geography which is seen as a problem so far, is not a problem after globalization. Electronic trade is growing in each day as a consequence of ICT. It is obvious that the improvements in ICT engineering result in many transformations in different fields of the economy and this tendency will be improving in coming years. Furthermore, service sector is one of the first which is mostly effected by developments in ICT. This improvements could be seen on linkages among the service sectors are getting stronger operation costs are declining and actors reaching the information more easily.

Service, in general terms, is an activity made in return of a kind of payment includes the mobility of goods, capital and labor. Service sector is one of the most developing sectors especially in the fields of marketing, distribution, communication and tourism. In this context the views evaluating service trade as a prerequisite are gaining importance (OİK, 2000: 3-10). From the time of agreement till final payment buyers, sellers, bankers, transporters, insurers, customs administration all hands are producing, forwarding, accepting and operating knowledge. These improvements support the consistency in service trade. Specifically, for conventional trade, in any shipment process 50 piece of documents are arranged and 360 copy of these documents are used in average. Information is demanded by the whole parts participating the operation besides the initiating person. Furthermore, in this process many mistakes can be made and it takes so much time to forwarding to relevant authorities. For example, it takes approximately 3 months for a west firm to contract with a Chinese firm in normal conditions and export may be even longer than manufacturing period. It is announced in the meeting of UN International Trade Facility that operational costs of conventional techniques consist of 7-10 % of world trade volume.

4. Regulations on Service Trade in the World and the Position of Turkey

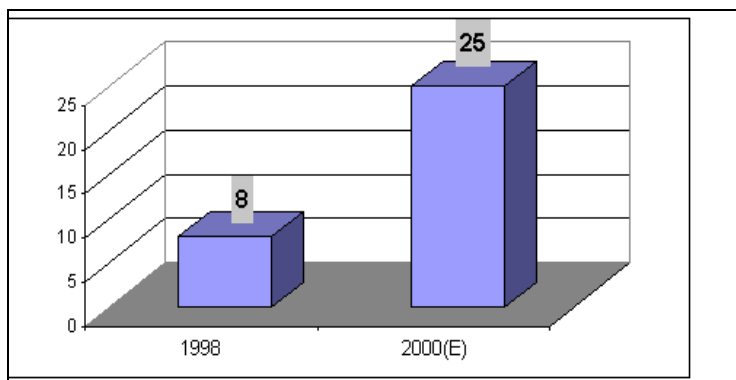
Currently, the WTO has failed to extend a moratorium on applying customs duties to electronic transmissions. The WTO agreed to a temporary moratorium on applying customs duties to electronic transmissions in 1998. This issue was to be decided at the WTO's Third Ministerial Meeting in Seattle. With the failure to launch a new negotiating round, the Ministerial Meeting was unable to discuss the issue. Since then, WTO members have been unable to extend or to make permanent the moratorium on applying customs duties to electronic transmission. At present, WTO members have no legal obligation to apply or not to apply customs duties to electronic transactions. However, with the current business

enthusiasm for e-commerce, the increasing importance of electronic transactions, and the complex nature of the General Agreement on Trade in Services (GATS), the WTO has to find a way to eliminate uncertainties and declare the rules of electronic transactions of services, and therefore customs-duty-free (Lopez, 2000: 559).

Turkey joined the GATT in 1951, under the Torquay Protocol, participated all subsequent rounds of multilateral trade negotiations, and became an original member of the World Trade Organisation (WTO) on March, 26 1995. Therefore, it has the opportunity of MFN (Most Favored Nation) treatment, at least by the trade partners, and has preferential trade agreements with a number of countries. It has amended legislation in the areas of intellectual property, safeguards, anti-dumping and countervailing measures. Turkey has made extensive commitments under the Multilateral Agreements that resulted from the Uruguay Round; it is an observer to the Multilateral Agreements on Government Procurement, and Trade in Civil Aircraft. It is attaching great importance to the Doha Development Agenda (Togan, 2005: 1229).

Turkey's commitments in the frame of GATT are vocational services (services that require specialism, computer and other services), services of communication (postal services, courier services, telecommunication services), contractorship and related engineering services, educational services, environmental services (sewage, garbage collection), financial services (banking, insurance, etc.), health related services, tourism, transportation, air transportation, railway and land transportation. It can be seen from the table that service trade is developing with economic growth and this process is stil going on. However, service trade is faster in the countries that adopt ICT.

Table-1: Amount of Trade Over Technology in Turkey



Source: IDC (International Data Corporation), 2000.

Turkey has to rely on ICT and trade service policies and implement middle and long term policies of improving ICT (Söylemez, 2001: 58-59). Otherwise, Turkey will be far from benefiting global competition and will have to be in a position of low technology thrid world country. It is not possible for a country to be competitive in foreign trade without capturing it's own export potential. The most important effect of information society is the acceleration of productivity growth. Productivity growth could be sustained with cost savings besides labor productivity; in turn this provides total revenues of the economy.

5. Conclusion

The concept of globalisation is experienced more pronounced way as of mid-1980s. Cultures are converging and nation states are losing their power with globalization. On the other hand, the issue of competition becoming the main force of trade and countries are forced to make new innovations with globalization. ICT become a main force changing the structure of service trade. While the obstacles of market entry and exit are eliminated with globalization, having knowledge will increase competitive power. Monopolist tendencies converge to technology centered sectors. Under this circumstances, competitive position is changing according to the short and long term conditions. Turkey is at the beginning of e-transformation about services sectors. In this respect, state and education institutions have many work to do. Governments are expected to liberalize the organizational, institutional and legal arrangements for ICT, and its infrastructures.

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UNREGISTERED EMPLOYMENT IN TURKEY

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Abstract

It is vital for the Government- as a whole of organized institutions and associations- to be aware of economic and social developments in its borders. That the economy of the government is registered and therefore presence of reliable statistical information have important effects on the functions which the government undertakes such as for whom and how much commodity and service it will produce, how to finance the expenditures for these products, in the light of which data that the policies to be produced will be drawn for economic and social life, and how to create social peace and free competition environment.

Informal economy is an important problem of underdeveloped and developing countries and just as the developed countries. Unregistered employment constitutes the major step of informal economy in all countries because informal economic actions are executed thanks to unregistered employment. In case that the individuals do not perform unregistered actions, it cannot be mentioned about informal economy.

In this paper, the reasons of unregistered employment in Turkey, its effects and comparison with the world will be dealt with.

Key words: *informal economy, unregistered employment, employment taxes, social security bonus.*

JEL: *E21, H20, H30, J38, K34*

1. Introduction

Economic life in our present-day world has a multi-functional and complex constitution. The number of the goods and services has increased, the technologies used have developed, employment facilities have changed and diversified, the developments abroad and inland have changed economic actors and positions. Such quick and multi-dimensional changes and developments may not allow the government to control and regulate what happens in economic life.

The rules which are set up by the government to arrange economic and social lives cause the ones wishing to earn more money to get closer to informal economy. Although the individuals and institutions which are active in informal economy carry some risks, they will both earn more money and get rid of some kinds of bureaucracy. However, these activities include disadvantages for the government and other individuals and institutions. The government is deprived of taxes and other official revenues which are unregistered. Other individuals and institutions are affected negatively due to unfair competition.

Unregistered employment and informal economy are the concepts which are bound to each other. The ones who produce informal goods and services and who do not notify this to the local government usually employ unregistered workers. The most important problem emerged with the reflection of informal economy over working life is the unregistered employment which emerged as employing unregistered and undeclared illegal worker or working unregistered in his self name and account by violating the rules and regulations

which make it mandatory to obey social security system and the law rules regulating the working life. While unregistered employment is in the form of not notifying the labours of the workers to public establishments; it may also be in the form of incomplete notification of labours as day and payment.

Informal economy is closely related with the development levels of the states. From developed countries to underdeveloped ones, proportion of informal economy in national economies represents accrual.

Actually, proportions of informal economy and therefore unregistered employment in underdeveloped and developing countries are quite high. Unregistered employment in Turkey as a developing country makes up half of the employment in parallel with informal economy.

In the study, concepts of unregistered employment and informal economy will be explained and the tight relation between them will be dealt with. Afterwards, the reasons of unregistered employment and its economic and social results will be given place. In the last part, dimensions of unregistered employment in Turkey and in the world will be compared and works and solution proposals devoted to curb unregistered employment will be mentioned.

2. Concepts of Informal Economy and Unregistered Employment

2.1. Informal Economy

If it is to make a general definition, informal economy is the whole of economic activities that cannot be estimated according to known statistical methods used to calculate gross national earnings and revenue bringing. (Derdiyok, 1993: 54).

The concepts such as underground economy, informal economy, hidden economy, secret economy, second economy, black economy, illegal economy, untied economy, irregular economy, parallel economy, unreceipted economy, invisible economy, marginal economy, shadow economy, loss economy, tax-exempt economy, are used instead of informal economy. Informal economy- from the point of taxation- is the whole of activities which are left out of knowledge field of tax administration with the incentive of tax-evasion and avoiding from taxation. (Altuğ, 1994:15).

2.2. Unregistered Employment

Unregistered employment is generally keeping the workers away from awareness of the government, employing unskilled workers, violating the regulations such as minimum age level (child labour), minimum wage, overtime, workplace standards, health and security of workers.

According to this definition unregistered employment: means the ones who are not enrolled in any social security institution for the work s/he makes in the reference week. According to another definition, it is non-declaration of the workers to related public institutions and organizations or avoiding from legal responsibilities such as tax and social security bonuses etc. due to incomplete declaration (MLSS, 2004a:27). Then -as understood from the definition- the most important aspect of unregistered employment is reduction of public revenues.

2.3. Relation between Unregistered Employment and Informal Economy

In a country where there is no informal economy, it cannot be mentioned about unregistered employment. There is a close relationship between unregistered employment and informal economy. The ones producing goods and services unregistered also employ unregistered workers. So, in the countries where informal economy is high, the unregistered employment is high, too. In the rising market economies, it takes the attention that economy and employment have shifted to unregistered and informal ones in increasing intensity since 1970s. But, informal economy, when both Turkey's economy and other countries' experience

are observed, is in a very complicated and multi-dimensional structure with its reasons, results, and operation. While expansion of informal economy causes the workers to become unsecured on one hand, and it causes on the other hand unfair competition against formal economy. Most importantly, it causes public shortfalls to get bigger and the social security system to break down by giving way to reduction of finance resources hoped to be supplied by taxation revenues (Us, 2004;1).

3. Reasons of Unregistered Employment

The main reasons of unregistered employment are these (MLSS, 2004b, 4);

-Excessiveness of responsibilities and formalities about employment: The most two important reasons of increasing volume of informal economy are tax load and taxation regulations of the public. There is a positive relation between them. As the tax levels and legal regulations increase, the cost of informal economy increases, too (Han et.al., 2006:237).

In addition to tax and other loads that the government takes from over the workers, excessiveness of the formalities as a result of employment's declaration makes informal economy tempting. The cutbacks from the salary such as insurance bonus and tax constitute a big load for the employer.

The major element which determines presence of market economy is competition. Informal economy which impairs competition conditions has aggravated the crisis which is experienced currently. The employer who at last notifies his insured worker to the institution falls back in the competition while fulfilling heavy fiscal responsibilities. The employer whose profit decreases is shifted to informal economy after some time as he will be disadvantaged in comparison to the one who makes production via illegal worker.

- Unfair distribution of the income, poverty and unemployment: Added value that the poor and low-educated workers produce in the production is low, too. As a result, the bonus and tax paid for these people may surpass the added value which these people produce.

- Lack of efficient inspection: Especially public institutions in underdeveloped countries are not efficient. Lack of inspection mechanism and non-deterrent fines make unregistered employment tempting.

- Unattractive social security services: Social security services interest individual's future closely. Social security services which minimize the concerns and possibilities about the future are seen as a serious deficiency in developed societies.

- Highness of unemployment rate and lowness of added value of the employment and uneducated labour power: In the studies carried out, it's been found out that education levels of the people working unregistered are low. As the chance of work choice for uneducated people is low, they find works unregistered.

- Lack of coordination and corporation between public establishments: In coping with unregistered employment, the government and citizens must have mutual agreement. A serious corporation between state agencies must be provided because unregistered employment entails corporation of more than one state agency.

- Reasons arising out of social security system: Dissatisfaction of the services that social security systems offers bring unregistered employment with itself. In this case, the insured applies to agree with the employer and by leaving his/her works unregistered partly or wholly (as daily or wage) he or she may wish the employer to add the money to his wage which the employer pays to the institution.

4. Results of Unregistered Employment

It is inevitable for the government to struggle with unregistered employment together with its all institutions and associations for expansion of production and employment, prevalence of social security, arrival of health and social security services to a certain standard, clearing away fiscal crises in social security institutions and state finance.

There are positive and negative effects of unregistered employment in economic and social lives. Negative effects: It creates unfair competition (Türk-İş, 2005:2, Us, 2004:15, Gümüş, 2000:68), reduces tax revenues (Us, 2005:95), impairs the trust to the government, curbs the reliability of statistical information (Türe, 2004:138), destroys income distribution, causes the country to reach at macro plan and its goals (Han vd., 2006:236), reduces loan point of the country, causes disqualified production of goods and services, impairs social life (law system) (Türk-İş, 2005:3), supports inflation, enhances unemployment, decreases production and investment, reduces export, causes brain drain (Alptürk, 2007), hinders developments of syndicate activities, employment fields which are deprived of social security and are unhealthy.

There are some benefits of unregistered employment: These are: It provides employment (Türk-İş, 2005:3), supports economic growth (Sarılı, 2002:44), supplies optimum distribution of the resources (Altuğ, 1994; 67), increases competition power of the country (Sarılı, 2002:44), and increases tax revenues.

5. Positive Effects of Taking Unregistered Employment under Registration

With taking unregistered employment under registration, the following results emerge (MLSS, 2004b;32):

- Bonus revenues of social security institutions will increase
- With the increase of bonus revenues, relatively real increase can be achieved in the pensions
- The quality of health and insurance services provided by social security institution will increase
- Financial burdens on the institutions which work in accordance with the rules will reduce.
- With the increase of registered employment, social security bonus levels that workers and firms pay will reduce gradually.
- The people who work unregistered will have health and social security rights that they were deprived of formerly.
- Competition conditions which operate positively in the direction of unregistered firms will shift to the ones which realize its legal responsibilities and pay its taxes.
- Qualified workforce and therefore productivity will increase.
- With the reduction of unhealthy employment conditions relative reduction will occur in work-related accidents and occupational disease.
- Child labour will diminish.
- Employment conditions of women, handicapped people, and other people open to abuse will get better gradually.
- Unregistered foreign workers will be prevented.
- Urban strawl problems arising out of immigration will disappear.
- It will provide work security system to develop into more positive points
- Credibility and investment reliability in international arena will be gained.
- Justice in taxation will be accomplished.

- With the increase of registered employment, it will be reached to an organized society via unions.
- Substandard and disqualified goods and service production will reduce.
- Economic plans will be able to be done on the basis of more realist data.

6. Dimensions of Unregistered Employment in Turkey and in The World

In this part of the study, firstly unregistered employment rates in some countries will be dealt with. The relation between countries' development levels economically and unregistered employment rates will be highlighted. Afterwards, the number of unregistered employment in Turkey will be given. The reasons of high proportion of unregistered employment in Turkey will be explained and policies about the solution of the problem will be proposed.

6.1. Unregistered Employment in the World

Experimental findings show that unregistered activities are more prevalent in underdeveloped countries (Carillo-Pugno, 2004:273). Unregistered employment grows on a vast scale according to OECD data, except for Russia. Unregistered employment in Brazil takes up half of the whole employment, and in India %85 (OECD, 2007:2).

Table1: Dimension of Unregistered Employment in some Countries

| Countries | Share of Unregistered Employment in GNP |
|-----------|---|
| France | 14.7 |
| Germany | 14.8 |
| Italy | 27.2 |
| Holland | 13.8 |
| Spain | 23.0 |
| Sweden | 19.5 |
| England | 13.0 |
| USA | 10 |
| Peru | 60 |
| Niger | 76 |
| Turkey | 48.9 |

Resource: www.tisk.org.tr, www.tuik.gov.tr, Antunes-Cavalcanti (2005).

Unregistered employment increases 2-3 folds more than the increase in GNP of the countries because informal economy grows faster than the formal one. The Table 1 represents the share of unregistered employment in GNP for Turkey and some countries. Unregistered employment rates are quite low in developed countries such as USA, England, Germany, Holland, France, and Sweden. The rate of unregistered employment in Italy and Spain which completed their developments later has a bit risen. The rate of unregistered employment in Peru and Niger which are underdeveloped is quite high. Unregistered employment rate of Turkey which is a developing country is %48,9 (TSI, 2007:2).

The countries which have the biggest informal economy are the ones where inflation is constant, unfair and speculative earnings increase, the incomes are distributed unfairly, and the economy is out of control (Dura, 1997: 6, Toptaş, 1998: 85).

6.2. Unregistered Employment in Turkey

The sectors in which informal economy is prevalent in Turkey are agriculture, construction, retail commerce, traditional sectors like gift and home services, manufacturing and company services and reformist modern sectors where people are basically self-employed (Kenar, 2002).

The ways of unregistered employment in Turkey are these (Yereli-Karadeniz, 2004:182-194):

- Non-declaration of the works of the employee to related public institutions and organizations.

- Incomplete declaration of the works of employee as wage

- Incomplete declaration of the works of employee as day

- Non-declaration of the works in a second job

- Unregistered employment under the name of trial period

- Wageworkers declared to social security institution and non-declared to tax administration

- Unregistered employees who work unregistered on their own will (foreign illegal workers, child workers, retired people working unregistered, the ones taking orphan wage as well as working unregistered, the ones taking invalidity contribution as well as working unregistered, the people taking unemployment benefit as well as working unregistered, Green card owners)

In Table 2, the rate of unregistered employment to total employment is given

Table 2: Unregistered Employment in Turkey

| Total employment (Million) (a) | Unregistered Employment (Million) (b) | (a/b) |
|---|--|--------------|
| 23.747 | 11.612 | 48.9 |

Resource: TSI (2007).

According to the data of 2007, the total employment in Turkey is 23.747 millions. In proportion to country's population (73 millions), registered employment rate is low when it is compared to the world (%48). That new employment fields are not opened in parallel with the population growth increases both unregistered employment and unemployment.

6.2.1. Reasons of Unregistered Employment in Turkey

The reasons of unregistered employment show difference from country to country. Factors such as economic development of the countries, education level, social and cultural structures, psychology of taxpayer, loyalty to the government have effects on unregistered employment in different degrees. The major reasons of unregistered employment in Turkey have been explained below.

6.2.1.1 Injustice in The Distribution of Tax Burden

Tax burden is one of the most important indicators which is considered in assessing a country's public finance. This indicator implies how much of the resources are taken by the government in a country's economy. (SPO,2006:7).

In Table 3 the member of OECD countries and Turkey's tax burden is given. The increasing at tax burden's main reason in developed countries is the financing of the prosperous country and the reason in developing countries is cronic public deficit (SPO,2007:3).

Table 3: Tax Responsibility in OECD Countries (2003)

| Countries | Not Includes Social Security | Includes Social Security |
|--------------|------------------------------|--------------------------|
| OECD Average | 26,8 | 36,3 |
| OECD Europe | 27,7 | 38,9 |
| OECD America | 21,1 | 26,1 |
| AB 15 | 28,9 | 40,5 |
| Turkey | 25,9 | 32,8 |

Kaynak: OECD (2005), Revenu Statistics 1965-2004, Paris.

Tax burden in AB countries, insreases paralel to the increase of public share in economy. Especially in order to finance the social security deficit, tax burden increased fast and (including social security payments) it reached %40s. The increasing tendency at tax burden in last years has calmed down, even in some countries tax burdens decreased (SPO,2007:4).

In Turkey, espacially until the beginning of 1990 tax burden was at lower levels when we compare with OECD countries but by the beginning of 1990s it regularly increased, and its rate in the Gross Domestic Product was %25 in 1997, but it increased to %32,5 in 2003 and it is estimated in 2005 it reached %34,5 (SPO,2007:11). Tax burden is one of the most impotant indicator to evaluate a country's public finance. With this indicator, we can see how much of the source is taken by the country as a tax or under with other names. In Turkey when we look at the numbers it shows that the rate of money which goes from country resources to the state increases day by day.

Tax burden is high when it is compared to the world. But, tax burden is not distributed fairly between individuals, sectors and regions.

In the distribution of tax burden, a balanced distribution between direct and indirect taxes in UN-15 countries calls the attention (World Bank, 1991, 2). However; the distribution over the tax burden has changed with the participation of new countries (European Commission, 2005:6-11).

6.2.1.2. Deficiency in Finding Employment Fields

The big informal economy in Turkey means one out of every three workers in urban areas and three out of every four workers in rural areas are not enrolled in any social security institution. Consequently, few workers can get retirement, health and unemployment insurance (World Bank, 2006:2).

The rate of total employment to total population is low in Turkey. While OECD average is %64.3, EU average is 65.1; this rate in Turkey is %45.8. The unemployment rate of Turkey is high, too, when unemployment points are observed. Unemployment average of OECD countries is %6,7, EU's is 7.6 and %10.6 in Turkey (According to 2002 data, MLSS 2004b:101-102). Albeit the effective economic growth currently, finding employment and participation level to work-power in Turkey is rather low (World Bank, 2006:1).

In Turkey, %47 of the employment is in agriculture, %15 is in the industry and %38 is in the service sector. However; these rates in Europe are agriculture %12, industry %36, and services %52 successively (World Bank ,2006:17).

Turkey has represented an effective development since 2001 and this development has been supported by a series of reforms which provide to reduce inflation, to improve public expenditures, to pave way to increase foreign investments directly. Albeit the current effective economic growth, finding employment and participation level to work-power in Turkey is rather low (World Bank, 2006:1).

6.2.1.3. Burdens of Financial Loads

While tax and social security cuts on employment are the revenues for the government, they are elements of expenditure in terms of the employer. Increase of these

burdens means the increase in the expenditure of employing. Taxes and social security bonuses on labour in Turkey is quite high.

Table 4: Fiscal Loads on Employment in OECD Countries (%)

| | | | | | |
|----------|------|-------------|------|-----------|------|
| Turkey | 42,7 | Norway | 29,6 | Austria | 35,5 |
| Poland | 42,1 | Italy | 35,2 | Spain | 33,4 |
| Greece | 39,2 | Denmark | 29,6 | USA | 11,9 |
| England | 27,1 | Canada | 21,5 | Korea | 16,2 |
| Belgium | 40,3 | Switzerland | 18,6 | Australia | 16 |
| Portugal | 26,6 | Germany | 35,7 | Mexico | 18,2 |
| Hungary | 39,9 | Iceland | 11,0 | Japan | 24,9 |
| France | 41,7 | EU-15 | 31,6 | OECD | 27,7 |

Resource: OECD, Taxing Wages 2004–2005, February 2006.

* The rate of taxes taken from the wages and total of employer and employee social security bonuses to work-power expenditure, year 2005

According to the Table 4, Turkey is the country where taxes and bonuses on employment are the biggest. According to OECD data, Turkey takes place on the top list in terms of the burdens for employment tax between 30 OECD countries. In other words, the most deterrent application in terms of tax and insurance bonuses to curb employment increase in the world is in Turkey.

When the OECD data in which family tax support-prevalent in OECD countries- is taken into account, it is observed that %42 of average employment cost is allocated for employment taxes (taxes taken from the wages and social security bonuses) in Turkey which is on the top list. This rate is approximately %24 in the general of OECD, %17,6 in the USA, %9 in Ireland. It takes the attention that employment taxes have reduced in the USA, Hungary, Korea, Luxemburg, and Ireland in 2002. Social security institution bonus burden feeds unemployment and informal activities (MLSS, 2004b:58, MLSS, 2006:14, Korkmaz, 2001:276).

As there are empiric studies supporting the thesis that tax burdens on employment increase the rate of unemployment, there are other studies which manifest that quality of syndicate under structure, constitutional properties in collective agreement and similar fields can be effective in the relation which is in question (Brant-Burniaux-Duval, 2001:28). However; it is useful to assert that high fiscal burdens on labour do not give way to unregistered employment alone (OECD 2004:254).

6.2.1.4. Dissatisfaction of Social Security Services and Ignorance

The quality of the services in return for social security bonus affects the individual's bonus payment. Especially dissatisfaction of health services are not seen as the equivalent of the bonuses paid. Therefore, in the comparison of utility-cost inequality are observed between the services and bonuses paid. Problems such as ownership of the institutions by the government, employment of the state officials in the institutions, lack of enough inspection for the institutions reduce the demand for social security services.

Unemployment insurance must be able to be used more commonly. For the time being, less than %4 of the unemployed workers can enjoy unemployment insurance. However, this number is %14 in Korea, between %25 and %75 in the OECD (Verghis, 2006:16).

In the press announcement of ILO (International Labour Organization) dated 5th March, 2006; prevalence of unregistered employment in Turkey was stated (ILO, 2006:1). The people who are deprived social security rights, defenceless, and who are working out of

social security network are subjected to dangers due to working environment and health conditions.

6.2.1.5. Attitudes towards the Government

The government behaves quite seriously while collecting taxes and other revenues. It imposes fines on the ones who do not fulfill their tasks. But, tax amnesties due to political incentives disappoint the honest people who fulfill their tax tasks. Along with this, the government does not pay the same attention while it is spending these taxes and revenues because the government and local administrations don't check whether the expenses that they make are effective, productive, and appropriate. Therefore, instead of the most necessary needs of the people, expenses are made in the direction of the institutions. Also, speculations in the adjudication system of the government cause the thought that the taxes collected are not used appropriately. Policies of expenditure must change, except for tax and social security services.

6.2.1.6. Lack of Inspection

The possibility of tax evaders to be inspected is rather low in Turkey (%2-3). The employers who do not fulfill their tasks about employment are aware of the fact that they will be inspected with a low possibility. In addition, though they are punished as a result of inspection they carry the hope that amnesty will come out. So lack of enough inspection and control push the individuals to unregistered employment.

It is not possible to put forward the inspection as the solution of unregistered employment. Unregistered employment implies a structure which feeds from the current economic system and which reflects closed agreement (T.R. premiership, 2006).

6.2.1.7. Low education level

For the relation between education level and unregistered working to be understood, distribution of education level in profession groups and unregistered working needs to be examined. Employment type which has low education level is observed more in agriculture and non agriculture production activities whose unregistered employment is high. The people who have high education level work in profession groups where unregistered working is low. While the people graduated from primary school or with lower education are active in agricultural profession group where unregistered working rate is the highest, %91,2 of unregistered working rate which is largely %51, %55,9 of the people graduated from university works in the profession groups of scientific and technical personnel, self-employed people, and related professions which has the lowest unregistered working rate of %7,1.

6.2.1.8. Unemployment

The employees and employers have disagreements between themselves in making informal economy into formal one (Valk-Süral, 2005:59). While the employees demand more money and more flexible working conditions, and the employers the opposite one.

Besides the disagreement between the employers and the employees, there is unemployment level of %11 in Turkey. The rate of the uneducated and unskilled people in unemployed fashion is quite high. Such people admit to work on low salary and without any social security. These conditions are more tempting instead of being unemployed.

6.2.1.9. Political Indifference

That the half of domestic income and employment is out of registration must worry the politicians. Because these both reduce tax revenues and impairs social regularity. But, this situation suits the politicians' purposes as the struggle with informal economy and unregistered employment will cause loss of votes. Additionally, unregistered employment and informal economy will consolidate the soul of enterprise in the future (Carillo-Pugno, 2004:258).

7. Struggle with Unregistered Employment in Turkey.

A circular published by Ministry of Social Security and Labour and The Project of Struggle with Unregistered Employment (PSUE) went into effect in 4th October 2006 for a comprehensive struggle with unregistered employment in Turkey.

The aim of the PSUE project: support of the works to minimize the rate of unregistered employment in total economic growth, making public opinion conscious of the long term disadvantages that unregistered employment will cause.

In the scope of E-Government applications, it is shifted to e-declaration application for working life. So taking the individuals under record will be easier and available.

Only legal and administrative regulations are not enough to increase the registered activities in the economy. It mustn't be forgotten that even if the best tax regulations are prepared and they are applied in the best way, the results expected from these regulations will not be realized unless tax awareness and ethic are not developed in the society (Sarılı, 2002;49). So the volume of registered employment can be increased with the common attitudes of government and all sectors of the society.

8. Conclusion and Assessment

There are various reasons for unregistered employment. While the rates of unregistered employment can be different from country to country, the reasons of unregistered employment represent difference. So there is no one recipe and solution way for the problem of unregistered employment.

While the tax burden is not heavy in Turkey, the distribution of tax burden is not fair. This unfair distribution causes taxes to stay over some certain parts of the society. The taxes must be distributed to the basement and tax rates must be pulled to a reasonable level for a fair tax distribution.

The economy of Turkey grows constantly and its population has increased. However, in employment facilities, there is not increase at the same level. This brings unemployment and unregistered employment with itself. Reduction of taxes and other burdens on production, investment, and employment will bear new employment facilities.

Social security and tax cuts on employment in Turkey take place at the top list among OECD countries. Reduction of these costs which increases the expenses of the employers will both increase employment and reduce unregistered employment.

Education level and unemployment rates are closely related with unregistered employment. It must not be forgotten that allocating more share for the education in government budget will add to the development of the country in the long term.

Increasing the quality in social security services and especially in health services, and making the society conscious of social security increase registered employment.

Efficient and enough inspection mechanism, deterrent fines are effective in preventing unregistered employment. Increase of the inspection officials and good education of them is important in this respect.

Struggle with unregistered employment must be effectively carried out in corporation with society, public administration and civil society institutions because this struggle is carried out by social agreement. Consequently, economy of the country and social life will be affected positively.

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IS THE DEBTOR SOLVENT : THE CASE FOR TURKEY

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Abstract

There is a broad range of literature on economic crises witnessed, with the recent experiences we had in Far East Asia, Argentina, Mexico, Brazil and Turkey. Although there are still debates on the triggering mechanisms, it is a common accepted fact that, large and consistent fiscal deficits, market imperfections, over burden of foreign debt and shallow fiscal markets are among the factors contributing. As in the case of Ricardian equivalence, a debt-financed reduction in government revenue should not effect the exchange rate or the current account shows very conflicting conclusions.

This paper aims to explore economic growth, import demand, external debt, exchange rates and public debt linkages. Two alternative models have been explored which shows that among the given variables there is no long term impact. VAR technique had been adopted to find the impulse-response relations. For the 1990-2006 period examined data set shows that there is a meaningful linkage as hypothesized. Findings also show that there is a case of internationalization of external debt which is consistent with the Turkish experience.

Jel No: F32

INTRODUCTION

Equilibrium models imply that the real value of debt in the hands of the public must equal the expected present-value of surpluses. Empirical models of fiscal policy typically do not impose this condition and often do not even include debt. Absence of debt from empirical models can produce non-invertible representations, obscuring the true present-value relation, even if it holds in the data (Chung et al., 2007). There is a broad range of literature on economic crises witnessed, with the recent experiences we had in Far East Asia, Argentina, Mexico, Brazil and Turkey. Although there are still debates on the triggering mechanisms (Burnside, Eichenbaum and Rebelo 2001), it is a common accepted fact that, large and consistent fiscal deficits, market imperfections, over burden of foreign debt and shallow fiscal markets are among the factors contributing. As in the case of Ricardian equivalence, a debt-financed reduction in government revenue should not effect the exchange rate or the current account shows very conflicting conclusions. (Elmendorf and Mankiw 1998). There are also issues of arbitrariness in positive public finance, which is dominated by the delegation of political control (Persson and Tabellini 1999). International market borrowing dominated by IMF, for most emerging markets mostly led to huge output declines followed by a currency crises (Hutchison 2001). Besides these debates on stabilization and growth issues, it is a common belief that, external debt issues should not be taken in isolation from the general macroeconomic setting. Foreign debt has very close linkages among fiscal budget, foreign reserves, and overall balance of payments (Feldstein, 1992) and also Edwards(2008) wants to explain the crises effects on Latin America.

In this research we aim to see the interactions among, economic growth rate impacts on trade balances, on exchange rates and external debt and eventually on internal debt. The second or twin aim is to see the short or long term effects of innovations under the models

tested. Before covering our formal model more rigorously, we would like to show some recent macroeconomic developments in Turkey.

Recent financial crises in Turkey have shared the following features:

- Large internal debt
- Large external debt
- Shallow financial markets
- Persistent high inflation rates
- Evolved through a complicated interaction of domestic financial and real sectors
- Sharp growth slowdown and very high devaluation's

Starting with 1990's Turkey became a relatively more outward oriented country, where he is more vulnerable to international market developments. This paper starts with the conventional open market economy models and its relevance to Turkey. But major part of the paper will be devoted to providing a rationale for the macro interactions among macro aggregates, which can trigger imbalances.

The classical question of economic growth is why there are structural differences among economic growth rates among countries. Turkey in this respect seems to be very lucky achieving a 4.3 percent average economic growth rate annually during the last decade. From simple income determination model we can state that Net Foreign Assets (NFA) of a country is equal to

$$\text{NFA} = \text{Net Foreign assets} = \text{Assets owned by Turks from abroad} - \text{Liabilities of Turks towards foreigners} = \text{Turkish Foreign Assets} - \text{Turkish Foreign Debt} \quad (1)$$

If $\text{NFA} > 0$; Turkey will be a creditor country

If $\text{NFA} < 0$; Turkey is a debtor country

Although economic growth is a favorable factor for an economies performance, it usually have a negative effect on trade balances (Exp-Imp). Usually provoking the induced import demand. Newer the less in a country like Turkey where public sector borrowing shows severe difficulties given the limitations, re-structural attempts become a must. During the era of 1950 –80, it seems that internal overall savings did not create any restriction on public borrowing in Turkey. But outward orientation attempts, which starts during the post 1980 period, put additional restriction on Turkey's trade balance due to the new liberalization attempts, which simultaneously increased the foreign borrowing and thus the foreign debt. Another event, which took place at the same era, is that public investment obligations shifted from internal resources, towards external resources. Increasing domestic interest rates caused a sharp increase in borrowing rates, which quickly led to a "crowding out effect". Decreasing private investment in time led to a decrease in productive capacity enlargement.

Starting from 1985, there is a drastic increase in foreign debt. As an indicator, in 1985 foreign debt had been 25 billion USD while in year 2001 foreign debt increase to 140 billion USD but till 2000 foreign debt seems to be more sustainable then the public debt. Examining private sector foreign debt, we see that, debt finance had been mostly used for public deficit finance instead of productive renewal investments. In 1999, public finance shows that internal turnover of public debt has reached to its limits, making it impossible to turnover for year 2000. This lead to a stand by agreement with IMF in December 1999, which reduced public expenditure, initiated another attempt for privatization while using exchange rate anchor to reduce expectation to reduce inflation, which is another source of increasing public debt. We should not forget that there is an interesting linkage between economic growth rates and the real interest rate. As long as economic growth rate exceeds real interest rate there is a chance of reducing public debt if the political authorities has established a discipline on the monetary

base. That is also true in the case of bond finance. As in most emerging markets Turkey's intention of initiating a financial stabilization program had been restricted by short term coalition governments. The issue became more sophisticated with the Maastricht Agreement where membership towards EU demands better macroeconomic performances. Although it is a legal and administrative requirement to prepare the annual budget as in all countries, there had been no year where the public expenditure has been restricted by the annual budget limits Turkey. In short, discipline on expenditure, internal and external revenue generation has not yet been established in this emerging country.

THE MODEL

This study aims to put forward the triggering mechanisms on internal, external debt dynamics. We hypothesize that initial momentum comes from the economic growth process. Increases in economic growth rates triggers the import demand where the induced part of imports makes up the 60% of total imports. An increase in foreign exchange demand independent of domestic inflation rates leads to foreign borrowing and depreciation of the local currency. These developments can be translated as increased foreign borrowing and internal aspect of increasing public debt, which further triggers further internal borrowing. To test these implications we will use OLS and a dynamic time series analysis technique; Vector Auto Regressive Model (VAR) which tests the implications of innovation on economic growth and its chain reactions on trade balances, external borrowing, exchanges rates and on domestic borrowing. We hypothesis that there are meaningful short term shocks which at the end restricts the economic growth rate.

Our formal model has the following properties:

$$\ln dtradebalance = \alpha + \beta_1 \ln gdp + \beta_2 \ln er + \beta_3 \ln exdebtstock + \beta_4 \ln internaldebt \quad (2)$$

lngdp = percentage change in real GDP

ln er = percentage change in exchange rates

dtradebalance = absolute change in first differenced trade balances

ln exdebtstock = percentage change in external debt stock

ln internaldebt = percentage change in internal debt

All quarterly variables belongs to Turkish Central Bank, quarterly GDP and foreign trade data belongs to State Institute of Statistics. Period covered for the analysis is 1990-2000. Gdp variable included seasonality. So we adjusted with CensusX12. We have deliberately selected the above-cited period because it reflects a different economic structure in terms of exchanges rates and openness. We have used E-Views 5.1 in our predictions. During the estimation process initially unit root tests has been given to test the existence of stationary properties. Augmented Dickey-Fuller test shows stationarity of the variables:

Table 1: Unit Root Test Results:

| | ADF | p |
|-----------------|-------|--------|
| trade balance | 4,98 | 0,0001 |
| lngdp | -5,51 | 0,0001 |
| ln er | -6,28 | 0,0000 |
| ln exdebt | -2,95 | 0,0443 |
| ln internaldebt | -7,32 | 0,0000 |

First of all with OLS we want to show the relationship of the variables:

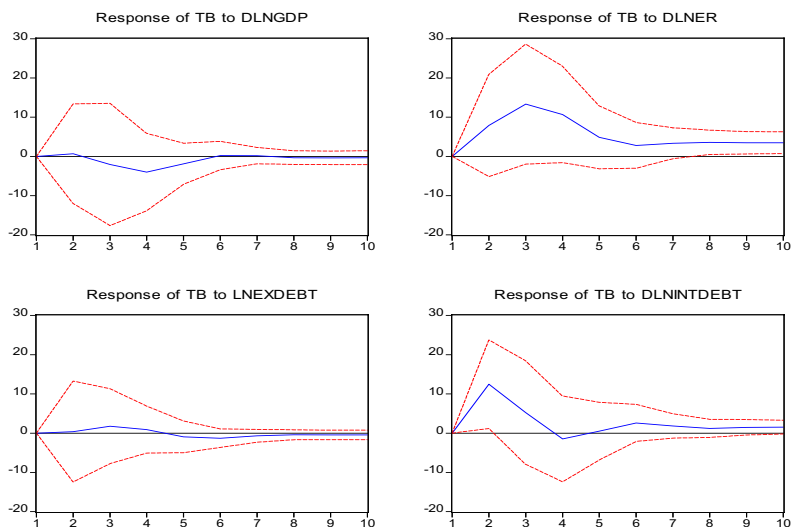
$$tb = 1020 - 272,56 \ln gdp_{sa} + 277,95 \ln er + 217,44 \ln exdebt - 139,47 \ln int_ernaldebt$$

| | | | | | | |
|---|--------|-----------|---------|----------------------|----------|-----|
| t | (0,34) | (-1,37) | (2,70) | (2,044) | (-4,00) | (3) |
| p | (0,73) | (0,17499) | (0,008) | (0,045) | (0,0002) | |
| | | | F= 30,5 | R ² =0,65 | | |

From this OLS above there is a positive relation between exchange rate and the trade balance. Here on this analysis trade balance is negative import exceeds export in Turkey on this period. When exchange rate increases export gets cheaper and import becomes expensive. Difference of export and import, increases on a negative form. Other positive relation is between trade balance and external debt. Debt is supported almost entirely by changes in the present-value of surpluses for some fiscal shocks, but for other fiscal shocks surpluses fail to adjust, leaving a large role for expected changes in discount rates (Chung et al, 2007). External debt's increase induces the trade balance in Turkey during the 1990-2006 period. There is a negative relation between internal debt and the trade balance variable. Internal debt means the saving part of the capital. But trade balance is from real economy. On this part of relation interest rate has a critical role. The interest rate effects the direction of money. Trade and interest income is alternatives of each other. These three connections are statistically significant.

Graph 1

Response to Cholesky One S.D. Innovations ± 2 S.E.



To see the short run relationship VAR analysis used. After the ADF tests to understand stationarity at the second stage we calculated the optimal lags for the above-cited data. The optimal lag was 2. From the impulse response function Graph 1 we can easily say that there is no short run relationship. Only one shock on exchange rate increases the trade balance. Whole VAR graph can be seen at the end of this paper. Addition of these two methods, Johansen cointegration analysis used too. But no long run relation could be found.

CONCLUSION

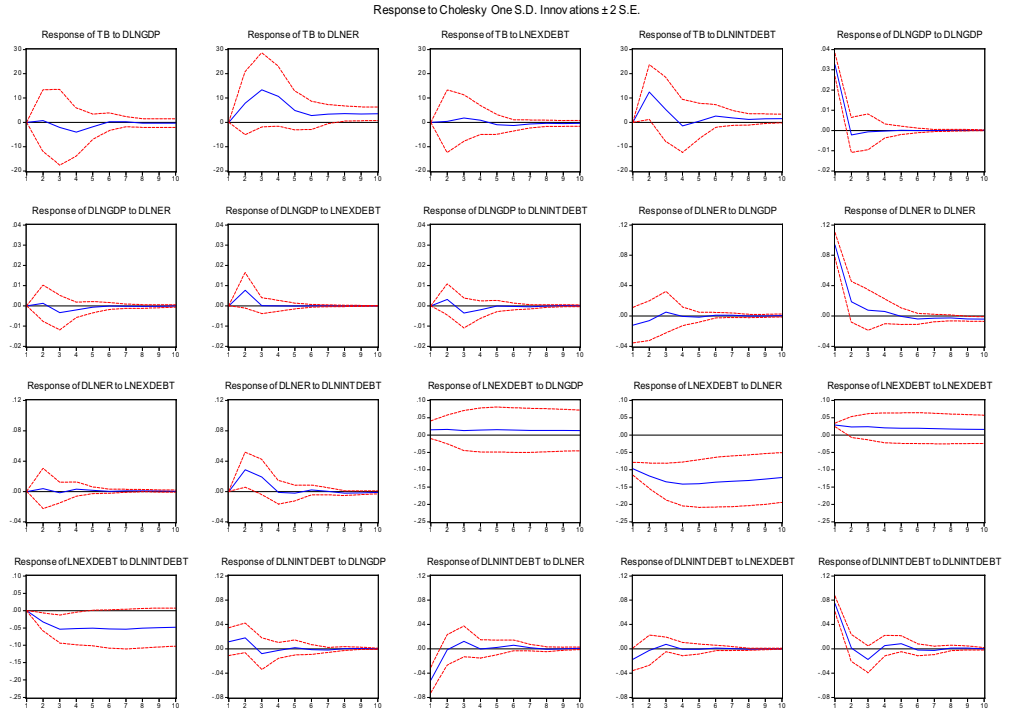
Overall findings show that, dynamic impacts of economic growth, trade balances, external debt, exchange rates and internal debt do not have long-term affects on each other.

One striking finding is that there are no long term impacts of innovations on each other, which can be translated as growth not restricting itself in the long run due to macro dynamics or innovation on variables stabilizing around averages in the short run. During the interpretation of our findings we should recall that lags in the implementation of monetary policy and interest rate benchmarks should be accepted as neutral, through out the period of analysis. Besides the domestic performances, international economic developments could be another source of dampening or magnifying factor on innovations.

We have started with the modest goal of looking at factors that leads to external and internal debt. Dynamic time analysis VAR had been used due to the nature of the data to assess economic growth and external-internal debt linkage. Major outcome of the study is that there are no long-term persistent impacts among variables.

APPENDIX

IMPULSE RESPONSE GRAPH



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