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CONFERENCE PROCEEDINGS

Vol.1

1st Annual International Interdisciplinary Conference, *AIIC 2013*

24-26 April 2013, Azores Islands, Portugal

(Conference place: **University of the Azores, Ponta Delgada**)

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MULTIPLE DISCIPLINARITY IN THEORY BUILDING: POSSIBILITIES OF COMBINING

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Abstract:

The article aims to strengthen theoretical development that will hopefully result in more systematic combinations and combined use of present approaches, such as frameworks, models and theories. At the same time this would increase multiple disciplinarity in future research. The objectives of this article are to describe why, when and how to develop theoretically new, combined approaches and illustrate them theoretically and empirically with the help of the former studies. Combining is examined in the connection of multiple disciplinarity. Business administration, especially marketing is used as a theoretical and empirical example area. Methodology is inductive and deductive logic and in the empirical examples surveys, case analysis and secondary data are utilized. This article introduces an insufficiently used but rather promising way, in the long run, to develop new, comprehensive and multiple disciplinary approaches and even paradigms for different disciplines. Consequently, the ultimate message of the article is to stimulate the researchers to put the idea and rationale for combining to the test in their own research field and to build new, combined and comprehensive approaches if possible in the field. This message is a multiple disciplinary one, embracing for example economics, social sciences and political sciences in addition to business administration.

Key Words: Multiple disciplinarity, combining, theory building, paradigms, practice

Background

The status of different theories is continuously debated as discipline and in practice. There really are some key questions. Have scholars too much specialized in narrow perspectives and thus failed to look at the bigger picture in theory and in practice? Can theory describe the real world?

Many researchers have also debated about paradigms, generally and in detail. For example, in organization studies this debate has seriously dealt with the different arguments that can be advanced for and against the idea of one single paradigm (Burrell 1966, Deetz 1996 and Pfeffer 1993).

The article aims to activate theoretical development work that will gradually result in more systematic combinations and combined use of present approaches, for instance such as frameworks, models and theories. This would naturally increase multiple disciplinarity in future research. The objectives of this article concerning combining aim at contributing to theory building in three major ways:

First, the article describes the idea and rationale of combining theoretically. This means that it describes why, when and how to develop new, combined approaches.

Second, the article utilizes the former business administration studies which illustrate the idea and rationale for combining, build some new approaches by combining present major approaches and examine them empirically. Marketing studies in particular are used as illustrative examples because combining has been studied in that area (see Lehtinen 2011a and b) and we can utilize the results of these studies here. But some studies in other areas of business administration are also referred.

Third, the article stimulates and even challenges the researchers of other disciplines, sub-disciplines and branches of sub-disciplines to put the idea and rationale for combining to the test in their own research fields and to build new, combined approaches if possible. New combined approaches could be also a potential basis for new comprehensive paradigms for many parts of different disciplines or, at best, whole disciplines.

As an additional second-level aim these three objectives concerning combining are examined in the connection of a multiple disciplinarity. Different issues dealing with the relationships of combining and multiple disciplinarity are mainly dealt with.

It may be expedient to start a discussion about the key concepts. Here combining means putting some originally separate parts together. In this article those parts are different scientific approaches. Combining is an act or a procedure that leads to a combination. Combining is more or less synonymous with uniting, joining, connecting, linking and integrating.

Here “discipline” refers to a particular body of knowledge, wisdom or learning, such as physics, biology, psychology, economics or business administration. Usually this knowledge is associated with one academic field of study or profession. The distinguishing lines between disciplines are often arbitrary and ambiguous.

Thus I use the term “discipline” when discussing some main area of science e.g. business administration. I use “sub-discipline” when referring to a part of a discipline e.g. marketing and I use “branch of sub-discipline” when speaking about a theory, model or framework of a sub-discipline e.g. marketing mix or relationship marketing.

The general term “multiple disciplinarity” is used to mean “multidisciplinarity”, “interdisciplinarity” and “transdisciplinarity”, when the level and nature of involvement of multiple disciplines is unspecified (cf. Choi and Pak 2006). Consequently, multiple disciplinarity is the cover concept for multidisciplinarity, interdisciplinarity and transdisciplinarity.

Multidisciplinarity is associated with more than one existing (academic) discipline. It draws on knowledge from different disciplines but stays within their boundaries. Interdisciplinarity is the knowledge extensions that exist between or beyond existing academic disciplines or professions. It analyses and synthesizes links between disciplines into coordinated and harmonized whole. Transdisciplinarity is more holistic and tries to relate all disciplines into a coherent whole. It transcends the disciplinary boundaries to examine the dynamics of whole system in a holistic fashion. This represents an interdisciplinary meta-theoretical perspective like structuralism. And as it was said earlier multiple disciplinarity is the cover concept for multidisciplinarity, interdisciplinarity and transdisciplinarity. (cf. Choi and Pak 2006, Besselaar and Heimeriks 2001)

All concepts concerning multiple disciplinarity are closely connected and sometimes used variably. Therefore, e.g. multidisciplinarity and interdisciplinarity are sometimes used as synonyms.

Methodology in the theoretical part of the article is both inductive and deductive logic. In the examples i.e. the marketing studies methodology also includes surveys, case analysis and utilization of secondary data, but the main interest here is in the results of these studies from the viewpoint of combining approaches and multiple disciplinarity.

Combining can also challenge some areas of present thinking in those parts of disciplines that are in the process of combining. It demands answers to many basic questions concerning particularly the approaches that are to be combined.

Idea And Rationale For Combining

Possibilities of combining in theory building have attracted little direct attention in research. In several research areas there are no explicit combining studies. Yet, there are many general reasons to explore the combinatory possibilities of two or more present approaches:

- when there is a need to create a new, comprehensive approach (theory). (For example, the business environment has become more comprehensive and complicated, and, therefore, researchers and managers need more comprehensive approaches.)
- where is a need or purpose to build some kind of general approach, which can cover two or more current approaches.
- when current approaches are not mutually exclusive.
- where current approaches have their own distinct strengths thus complementing one another.
- where current approaches have their own distinct weaknesses and the weaknesses of one approach can be at least partly offset by the strengths of the other and at best vice versa.
- if combining present approaches is a useful way to fill gaps between different theories, within specific theories, between theory and practice etc.

- if the generally accepted approaches can be so pertinently combined that the result is an acceptable combination.
- when present approaches are well-known, which makes adoption easier.

Rather often combining is a tempting and suitable possibility to proceed with if there is both rationalistic and behavioral or positive and normative research in some research area. This kind of combinatory situation is usually more or less interdisciplinary.

These reasons are quite frequently valid. At least they are often valid in many parallel branches of sub-disciplines.

For the same reasons, the new approach (theory), which consciously, systematically and equitably combines the essential and compatible elements of current approaches, should be more reliable, fruitful and profitable than any of the previous and separate approaches. Perhaps the main rationale for combining approaches is the possibility of offsetting weaknesses with strengths.

Especially in practice, but also in theory, many approaches within several disciplines have never been fully separated. For example, in marketing the sub-parameters of communication of mix approach, particularly PR and selling, are strongly related to relationship marketing approach. Therefore, a company using one approach inevitably integrates elements of the other approach(es) at least to some extent.

In principal, combining can be performed at all disciplinary levels. But making use of advanced combining will be most common and natural at the level of branches of sub-disciplines as in the marketing examples below, where marketing mix and relationship marketing approaches are combined. At the higher levels i.e. disciplines and sub-disciplines combining will often remain in the parallel use of approaches though the common use of different kinds of compatible knowhow is a generally approved goal.

Naturally there are different ways to combine approaches. Already the parallel use of different approaches can be considered a simple form of combining. The parallel utilization of approaches, often without any purposeful combining, seems to be quite common. It can also be an important phase toward more sophisticated forms of combining.

On the other hand, conscious combining can be very systematic and supported by careful analysis. Consequently, the forms of combining may vary from the independent parallel use of various approaches to the conscious and systematic combining. There are many variations between these extremes. In any case, a scrutinized combining should be based on interrogating the ontological and epistemological premises of approaches in order to see whether or not they can sit well together in one combined approach.

The way of combining may also depend on the characteristics of the case in question. Thus combining can be performed with different degrees of thoroughness. This thoroughness depends on how easy it is to find and combine different but compatible elements of the approaches.

Combining may be performed within one discipline or as an interdisciplinary combining across the boundaries of different disciplines. For example, marketing and organizational research have largely borrowed concepts and theories from neighboring disciplines such as psychology and sociology. Actually, marketing as well as management and organization can be considered multidisciplinary and interdisciplinary areas of inquiry. For example, Oswick, Fleming and Hanlon (2011) listed fourteen remarkable contributions of organization and management theory and only one of the proponents of these contributions was primarily a researcher of business administration. On the other hand, many socio-psychological, mathematically formulated models have been utilized in consumer behavior research which is quite independent as a research area within marketing research. These kinds of borrowings have been very fruitful and they can sometimes be rather useful when trying to find proper combinations.

As it was stated in several disciplines there are both rational and behavioral branches of sub-disciplines. These branches are based on the different visions of research and are thus complementary. Therefore, it is natural and almost obligatory to ask if these could be combined at least to some extent. Often combining is possible and useful and often the result is also interdisciplinary. The following marketing studies may be considered the good examples of this kind of combining.

Naturally the total combining of present approaches is not the only way to proceed. Present approaches can be utilized only partially when combining. On the other hand, elements that are not in any present approach may be included in a new approach.

Some researchers have dealt with concepts that are related to combining. For example, borrowing and blending are related to combining and can be utilized also in connection with combining (see for example Oswick & Fleming & Hanlon 2011 and Whetten & Felin & King 2009). But this utilization presupposes the careful consideration of the nature of these concepts and the characteristics of theory formation in question (Corley & Gioia 2011).

Examples: Marketing Studies Combining Mix And Relationship Approaches

Some examples of combining marketing approaches (called here the marketing studies) are now discussed and used as an illustration of combining. Even in marketing the idea of combining approaches has attracted very little attention though there are some studies that fairly superficially touch on the possibility of combination (see for example Kotler 1992, Gummesson 1995 as well as Pels, Coviello, and Brodie 2000).

In the marketing studies marketing mix and relationship marketing approaches are combined. These approaches are at the center of theoretical and practical marketing (see Grönroos 2007, Gummesson 2008 and Kotler 2006). They really are the major marketing approaches. Marketing mix approach is quite rationalistic and normative whereas the relationship marketing approach is based on a quite behavioral and positive vision. Therefore, their combination has a multidisciplinary or interdisciplinary scientific background.

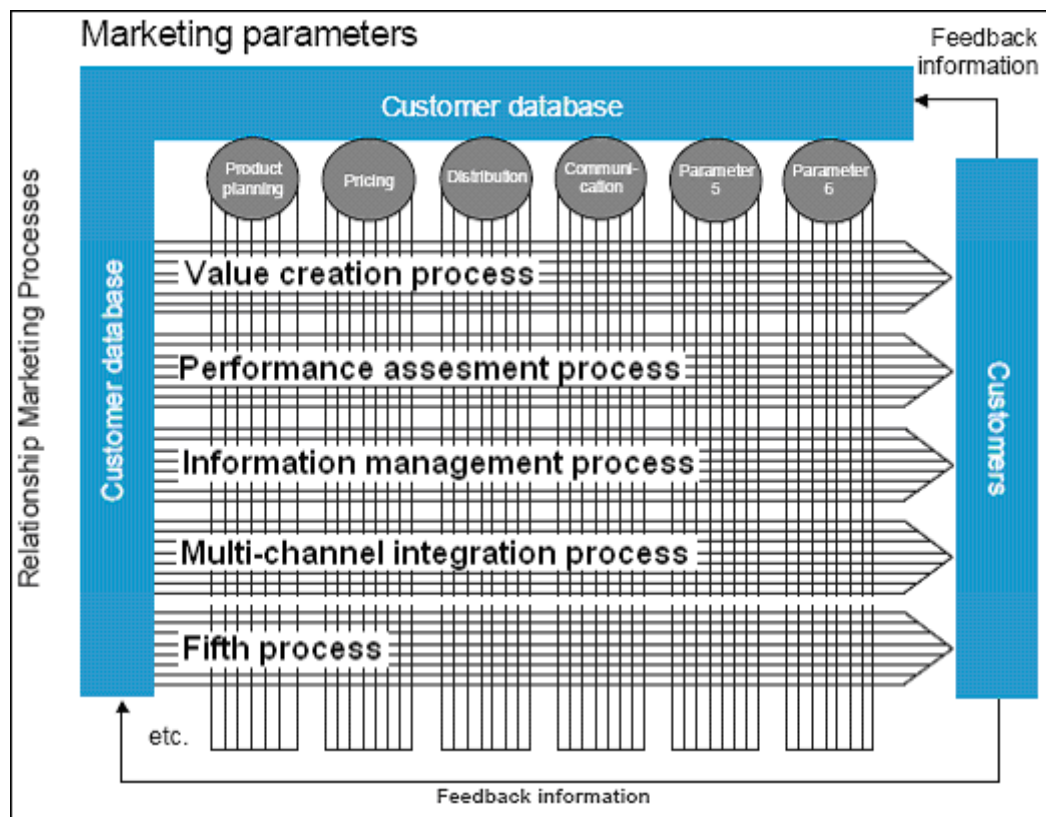
The idea and rationale for combining marketing approaches was scrutinized by Lehtinen (2007, 2009). The main objective of the marketing studies was to outline theoretically new tentative and conceptual approaches by combining the marketing mix and relationship marketing approaches and studying them empirically.

Some new combined approaches were developed according to the objectives of the marketing studies (Lehtinen 2011a and b). They serve as an opportunity to utilize both major approaches. Some weaknesses of one approach can be offset by the strengths of the other. The well-combined approaches probably offer a more comprehensive view of marketing compared to being considered separately or parallel.

When we speak about mix marketing approach and relationship marketing approach, we must recognize, that both approaches actually are offshoots of several different sub-approaches. Therefore, the fact is that we speak about the combining of one of the mix marketing approaches and one of the relationship marketing approaches. In other words, we can speak about the combining of a sub-approach of a branch of one sub-discipline and a sub-approach of a branch of another sub-discipline. These sub-approaches are based on the different scientific origins and in this sense the examination is interdisciplinary (see Choi and Pak 2006).

It is possible in theory and especially in practice to combine relationship marketing elements straight into the marketing mix elements (Lehtinen and Niittymäki 2006). In this way, we can take relational effects directly into account when formulating the use of the parameters of the mix in question. For example, if values of relationship marketing are taken into account in the pricing of marketing mix, the consideration of customers and the negotiating power and negotiating limits of the sales force are increased in price setting.

A fairly advanced combination framework is illustrated in Figure 1. It can be called the “RELMIX framework” (RELations-MIX framework).

Figure 1**RELMIX framework for combining marketing parameters and relational processes**

The framework is a matrix with the essential elements (parameters) of mix marketing on the horizontal level (on the x-axis) and the essential elements (processes) of relationship marketing on the vertical level (on the y-axis). The combining of elements happens at the intersections of parameters and processes (marked with vertical and horizontal lines). In principal, the number of intersections is the number of parameters multiplied by the number of processes used in combining. But in practice some intersections (or elements) can be left outside the combination work and thus they remain at the “zero level”.

We can regard the parameter and process areas outside these intersections (marked only with vertical or horizontal lines) as the areas where the elements can be developed independently. The markings “Fifth process” etc. in the figure illustrate the possible advancement of some new processes onto the basic process level. A corresponding practice concerns the parameters of mix, which is described by “Parameter 5” etc.

As to the disciplinary character, the RELMIX framework (see Lehtinen 2011b) as all advanced combinatory approaches can be considered interdisciplinary. In principal, the most advanced combinatory approaches can be transdisciplinary at least if the coherently combined approaches are scientifically quite far from one another. On the other hand, the parallel use of different approaches can be considered multidisciplinary but not interdisciplinary. Actually, the degree of multiple disciplinarity depends on the scientific difference of the combined approaches.

Lehtinen (2011b) has made four empirical studies (three surveys and one case study) and utilized three secondary studies. The quality of the empirical parts of the studies was maintained throughout the research work. Because the main results were almost identical in all three surveys, in the three secondary data as well as in the case study, all the results seemed to be quite valid and trustworthy. Taken together the empirical evidence was fairly clear for the purposes of this kind of preliminary empiricism.

The empirical results based on all seven marketing studies proved that there are clear gaps between marketing practice (manifested by empirical results) and current theories (manifested by the separate approaches of mix marketing and relationship marketing). At the same time, the results of these studies also confirm that there are a lot of parallel uses of both approaches; a significant use of approaches combined to some extent; and a strong need to explore how to combine approaches better, as well as a strong need to combine the marketing approaches more than before. Thus many companies have already utilized combinations of approaches at least in a modest form and the most companies really wanted to find a proper way to combine and would strive for more combinatory use of the approaches.

The findings of the marketing studies can be used in marketing management practice at least in a modified form. Applications naturally require plenty of time and attention from any company that wants to consider utilizing these new opportunities. Actually, no company can totally avoid the use of both major marketing approaches for the sake of the clear interdependencies of the approaches, but implementation will differ by company based on background factors such as the financial and competitive situation, the industry and the marketing competence of the people involved (Lehtinen 2011b).

One new practical solution in developing marketing is the addition of company-specific parameters or processes into combining processes (Lehtinen and Niinimäki 2006). These parameters and processes often strengthen customer relationships and solve some of the challenges concerning relationship marketing. Company-specific elements (we could also call them original or unique elements) can be based on unique features of the company or its personnel, the company's business models etc.

In real life, companies need a broad knowledge of different approaches of marketing and an ability to use them in an integrated manner (Möller and Halinen 2000, Lehtinen 2011). The ideas produced in the marketing studies can be used in companies' marketing decision making. The success of this utilization will reveal the practical value of combining these approaches.

The findings of the marketing studies clearly favor the continuation of scientific discussion and work on combining approaches. Especially the comments of managers in the discussions conducted after they had completed the questionnaire were both challenging and encouraging in this respect.

There is one additional possibility of theoretical development which could be called the total development procedure or strategy. This is realized if we try first to develop at least one (or at best all) approaches (theories) that we want to combine and then we combine these developed approaches. Quite probably, some part of the forthcoming scientific development in marketing will happen this way because especially relationship marketing is still a developing research area. At the very least the different numbers of parameters of mix should be tested when combining. In marketing the possibility of development concerns also the marketing mix approach (Lehtinen 2009, Lehtinen and Mäkinen 2012). Actually, many different disciplines are frequently developed in this manner though different anomalies and extended development time can obscure the procedure. Additionally the transformations of original approaches for combination can make the picture unclear (see also Lehtinen 2008a and 2008b).

Concluding Remarks

We can now return to the first key question presented in the beginning of this paper: Have scholars too much specialized their studies and narrowed their perspectives, resulting in a failure to look at the bigger picture in theory and practice? The results of the examples i.e. the marketing studies presented before suggest an affirmative answer to this question. But this article does not try to argue for a narrowing of perspectives. On the contrary, it seeks to broaden them.

There are gaps between practice and current theories according to the empirical results based on all seven marketing studies. As to the second key question presented in the beginning of this article, the major theories of marketing do not seem to describe the real world. By nature, marketing is usually considered as an applied science that should be largely based on the acts and needs of marketing organizations (see however Lee and Greenley 2010). Therefore, the gaps between the real marketing practice and theories should be reduced by empirical and theoretical research. Often also

combining approaches can theoretically be helpful. The results also favor the continuation of scientific examination on combining approaches.

This article introduces a insufficiently used but very promising new way to develop original, comprehensive and multiple disciplinary approaches and even paradigms. The anomalies of older approaches cannot be assimilated for very long, but in any case a new paradigm could emerge (cf. Kuhn 1970). The results of the marketing studies also suggested that a paradigm shift from the major approaches to combining them may eventually materialize.

It is a good reason to underline that we should have no implicit assumptions that combining or multiple disciplinarity as such are virtues. It is important to scrutinize different arguments that can be presented for or against the ideas of combinatory approaches or multiple disciplinarity. Even if we can develop some remarkable major approaches or achieve some level of multiple disciplinarity with the help of combining we must appreciate also minor theories that are fruitful in a limited area.

Often different approaches can generate different results in theory and practice and this may enrich our understanding of the phenomenon examined. Consequently, there can be sensible reasons for not trying to combine approaches and to support for example the parallel existence of approaches. On the other hand, some approaches can be so contradictory and incompatible that any combining is unwise or any combination is even impossible.

We must also understand that all forms of combining are not clearly multidisciplinary or at least interdisciplinary. But very many combinations are, because several combined approaches have rather different scientific backgrounds or at least somewhat different scientific origins.

It is natural that if two independent disciplines are combined, the new combination is literally multidisciplinary, possibly interdisciplinary and in some cases transdisciplinary. If sub-disciplines are combined the combination is probably multidisciplinary to some extent. And if some branches of a sub-discipline are combined, even the multidisciplinaryity of this combination is not self-evident.

All in all, the degree of multiple disciplinarity of the combined approach strongly depends on the nature of the combined approaches, especially the scientific distinction of the combined approaches. Therefore, combining can represent multiple disciplinarity even at the level of branches of sub-disciplines, if the scientific distinction between the combined branches is large. In the marketing studies described earlier the quite normative and rationalistic mix marketing was combined with the more positive and behavioral relationship marketing. Therefore, the combined approaches of two branches of a sub-discipline are multidisciplinary and the forms of combination can even be interdisciplinary.

In general, combining could be considered a procedure for or towards multiple disciplinarity. Actually, multiple disciplinarity may be impossible without some kind of combining of different scientific approaches. But probably combining is not the only way to multiple disciplinarity.

In any case, it is easy to believe that combining and multiple disciplinarity are probably increasing in the future theory building. Many reasons are presented before. Generally, it can be emphasized that it is reasonable to utilize the former successful work in theory building and its results i.e. current approaches.

The results of the marketing studies strongly encouraged a continuation of the scientific and practical work on combining approaches in marketing. But there is no reason to suspect that the basic idea and rationale behind combining are invalid in other sub-disciplines of business administration. For example, in accounting, in finance as well as in management and organization there are e.g. both rationalistic research and behavioral research. Thus some combinations of approaches in the main areas of business administration should be possible and reasonable. Combining can result in fairly comprehensive approaches and possibly even new comprehensive paradigms, which are more or less multiple disciplinary.

To the best of my knowledge it appears that the basic idea and rationale of combining could and should be utilized in very many disciplines in addition to business administration. It is easy to understand that this could be extended to for example economics, social sciences and political sciences in addition to business administration. Perhaps the scientists in most research fields should experience combining and, at the same time, multiple disciplinarity as fundamental challenges and possibilities when developing theory and practice.

Therefore, the ultimate message of this article is to stimulate and even challenge the researchers and research groups of different disciplines, sub-disciplines and branches of sub-disciplines to put the idea and rationale for combining to the test in their own research field and to build new combined, comprehensive and multiple disciplinary approaches if possible and useful in the field in question. Naturally, this message as such is rather multiple disciplinary. Sometimes research processes can even lead to new and multiple disciplinary paradigms.

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THE CHALLENGES OF ISLAMIC TRADE FINANCE IN PROMOTING SMES IN IDB MEMBER COUNTRIES

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Abstract:

Accessing financing is one of the most formidable challenges facing Small and Medium Enterprises (SMEs); particularly in the least developing member countries (LDMC) of IDB. Given their low capital base, the availability of financial resources is essential for the SMEs growth. This research attempts to investigate the challenges and limitations facing the use of Islamic finance to promote Small and Medium Enterprises (SMEs) in IDB member countries. Secondary data from member Countries were collected and analyzed to identify the binding constraints in using Islamic finance in promoting SMEs. The findings of this study show- that despite of the recent growth of the Islamic institutions and the development of new Islamic financing products, still there is no favorable environment for Islamic finance to play vital role in the development of SMEs in the IDB member countries. The main reasons might be due to the weakness in the development of trade and the Islamic financing infrastructures. Given the uprising unemployment in many member countries, this study makes specific recommendations to the governments, Islamic banks management as well as IDBG to contribute in removing the challenges associated with accessing the sources of financing to encourage Islamic finance to further promote SMEs

Keywords: Islamic financing, SMEs' in IDB member countries

Introduction

Small and Medium enterprises (SMEs) play a vital role in promoting economic growth and creating employment and have spur social development (Cravoy *et al*, 2009). SMEs also help in regional development and export market expansion due to their aggressiveness compared to the large corporation. IDB member countries need to encourage the establishment of SMEs to help them in promoting their economic growth and reducing poverty through jobs creating and income generation. The previous evidences showed that SMEs contributed over 65% of total employment and over 55% of the GDP¹. Accordingly many countries, developing or underdeveloped, largely depend on SMEs in promoting their economic growth and thus creating more jobs; which is vital for their prosperities. SMEs might help in solving the problem of high unemployment that exists in all IDB/MCs. That is because SMEs are more labor intensive which might be more appropriate if direct support given to them by the members and the IDBG.

The SMEs' support even becomes more important given the recent Arab spring in some IDBMCS such as Tunisia, Egypt, Yemen, and Syria, due to rising youth unemployment and economic slowdown. Nader K. and Ekta K. (2005) showed that the unemployment among the youth in some IDB member countries is more than 50%. Likewise, the report from the International Labor Organization on employment showed that the Middle East and North Africa (MENA) region has the highest unemployment rate in the world, at 10.3%. The unemployment is even higher among the youths in these regions which showed 26.3% for the Middle East and 27.1 for North Africa². Reducing the level of unemployment is very important for the social inclusion and future economic security in the IDB member countries. Hence, strong and direct support from IDB member countries' government for the development of SMEs is rather vital.

¹ 2nd OECD Conference of Ministers Responsible For SMEs (2004)

² International Labour Office (2012)

Despite their vital role in building a competitive private sector and contributing significantly to employment growth, SMEs are facing more challenges around the world due to the recent financial crisis and Euro Zoon debt dilemma. One of the most serious challenges is the difficulty in accessing financial resources. The lack of financing prevents SMEs from contributing effectively to the economic prosperities because of their lower capital, higher risks and less competitiveness. SMEs engage in many tradable activities domestically as well as cross borders. Hence, they require financing throughout their business process from the acquiring of raw materials during the pre-production stage until the final marketing of stage. Rocha R., *et al* (2011) have shown that SMEs become strategic tool for improving firm's competitiveness, generating employment, and raising the income.

The characteristics of the SMEs are not much different from country to country or region to region. The main common characteristics³ of SMEs are the capital that the company invested, the number of employees or the firm's turnover. Other determinants of performance such as the management style, the location and the market shares are also assumed as important features for SMEs.

The recent global financial crisis and the consequent economic imbalances have their relative impact on the sources of financing of SMEs in many countries around the world. The lack of funding was one of the major factors that prevent the SMEs from investment and innovations and slowing their growth during 2007/2008 financial crisis⁴. The financial crisis exacerbated the shortage in the liquidity and increased the existing high risk associated with the SMEs. Being small, SMEs were exposed to many sorts of risks during the financial crisis.

Like the SMEs in the global markets, SMEs in the IDB/MCs were also exposed to severe business risk, financial risk and even legal regulatory risk. Business varies between the SMEs in each IDB/MCs, depending on the nature of the business, the readability of enabling environment and infrastructure, skillful human resources, quality of internal management control, legal regulatory system for SMEs and the adoption of technology which is necessary for reducing the cost and enhancing the productivity. Managing these types of risks is very essential for SMEs to survive because it results in reducing the financial losses, the cost of unexpected expenses and the expected losses on the firms' revenue.

IDB member countries are not excluded from this financing impact despite the existence of some major differences in their financial infrastructure and in the way their financial institutions operate. Meanwhile, the negative effect of the financial crisis on the available financing sources for business has highlighted the importance of using Islamic finance to promote business activities in general and develop SMEs in particular. This is because the evidences in Hasan M. & Dridi J. (2010) howed that Islamic financial institutions were resilience to the recent financial crisis. These results put more burdens on the shoulders of Islamic financial institutions in and outside the borders of the IDB member countries to support the growing demand for the emerging financial system. Based on the above arguments, this paper attempts to investigate the challenges facing Islamic finance in promoting SMEs in IDB Member Countries.

Literature Review, Methodology and Data Sources

Literature Review

Recent studies on SMEs can be classified into two areas. In one area, more efforts have been given to investigate- the role of the SMEs in promoting economic growth, increasing the employment opportunities and prospering the people. The other area focused on hinders facing the SMEs when trying to access the available financial resources. While the shortage of conventional finance has been given more attention in the literature following the recent financial crisis, the challenges facing Islamic finance as an alternative to the conventional finance has got little attention in IDB member countries, the home of Islamic financial institutions.

³ European Commission (2009)

⁴ Department for Business, Innovation and Skills (2012), The Impact of the Financial Crisis on Bank Lending to SMEs (www.nationalarchives.gov.uk/doc/open-government-licence)

The previous literature supports a positive impact of the SMEs on the economic prosperity. Coskun, et al (2002) studied the managerial issues faced by Turkish SMEs. In the light of their finding, they discovered that there was an obvious need for designing and employing a strategy to capitalize on the emerging opportunities and avoid threat in the new business environment Beck, et al (2005) investigate the relationship between the SMEs and both economic growth and poverty alleviation using the share of SMEs labor in the manufacture sector for 45 countries. The results showed that there is a positive relationship between economic growth and SMEs but did not support the claim of the impact of SMEs on poverty alleviation. Saleh and Ndubisi (2006) evaluated the development of SME in Malaysia. The results of their studied showed that Malaysian SMEs faced more challenges among them low level of technological capabilities, limited skills of human resources, low level of research and development, high level of global competitions, high level of bureaucracy in the government agencies and the problem in the internal sourcing of funds. Tambunan (2008) examined the recent development of SMEs in Indonesia and Thailand. He concluded that while the SMEs are important to the two countries, they faced more constrains in both countries such as lack of technical and managerial capabilities, access to large markets, access to finance, skilled workers and the lack of access to the business information. Cheok, Khoo Sin (2008), studied the success stories of Malaysia SMEs in accessing global markets. He showed that while a number of government programmes and incentives were offered to the SMEs in order to contribute to the national economic, the impact is limited. Olawale F. and Garwe D. (2010) studied the obstacles to the growth of new SMEs in South Africa. They specifically concentrated on the internal and external factors that influence SMEs in South Africa. They found the financial factor is the major obstacles for the establishing new SMEs in South Africa in addition to markets, management and infrastructure. Abor, J. and Quartey P. (2010), investigated the characteristics and contributions of the SMEs to the economic development in Ghana and South Africa. They found that SMEs contributed more than 90% in the two countries formal business. Despite of their great contributions to these countries economics and employment, their research results showed SMEs were facing more challenges such as access to the appropriate technologies, lack of management and trainings, limited access to international markets, laws and regulations and weakness in the institutional capacity.

Calice P., Chando, V. M. and Sekioua S. (2012), in thier recent survey SMEs in four East African countries, found that SMEs are considered a profitable business prospect and provide an important opportunity for cross-selling despite of a number of obstacles constrained the banking system engagement in this important sector. The mains obstacles stated by the findings were SMEs related factors, macroeconomic factors, business regulation, legal and contractual environment, the lack of more proactive government towards the segment, and some bank specific factors.

Results of the above literatures show that SMEs represent an important segment in economic growth and one of the essential contributors to an employment in the countries. It also showed there are common challenges facing the SMEs in the members countries related to the funding the segment, the availability of well-trained and skilled human resources and government specific factors. Another evidence from the literature shows that although there are more studies related to the SMEs, the role of Islamic financing and the challenges associated with it were not given much attention by these studies compared to their conventional counterparts. Despite of the previous evidences that indicated Islamic banks showed more resilience in the recent financial crisis which has negative impact on the available conventional sources of financing for the SMEs, the proposed alternative Islamic financing and its related environment have never given through investigation to pinpoint their capability and readability for the replacement.

The Methodology and Data Sources

This research paper investigates the challenges facing Islamic trade finance in promoting Small and Medium Enterprises (SMEs) in IDB member countries. The main objective of this study is to determine the challenges that hinder the adoption of Islamic finance to assist in the development of the SMEs in the member countries and suggest the possible potential supporting parameters to encourage its implementation. To reach this end data is collected from Islamic Banks Information System (IBIS/IRTI) and other relevant secondary sources and analyzed to achieve the research objectives.

The Overall Environment of Islamic Trade Finance in IDB Member Countries

Islamic trade finance refers to financing import and export through Islamic financing modes and instruments. Trade finance has become one of the major challenges facing SMEs today. The situation of trade finance even becomes more complicated due to shortage of liquidity and scarce financial resources due to the recent global financial crisis. Unlike the larger competitive corporate firms which have strong economical and political bargaining power, SMEs have lower capital, high risk and less competitiveness. For these reasons and in addition to the recent difficulties facing the conventional finance, Islamic trade finance becomes the legitimate alternative to provide SMEs with the required working capital, shrink the liquidity gap, reduce the risks of insolvency and may help in improving their competitiveness.

Good facilitating Islamic trade finance might play vital role to the growth of SMEs in the IDB member countries. Being very active in import and export trade and having budget constrain, SMEs always demand easy financing throughout their trade cycle, from the very beginning stage of pre-shipping until the final processing of their products. SMEs also need post-shipping financing. The efficiency and effectiveness of Islamic trade financing depends highly on the quality of trade infrastructure development and the readability of Islamic financing infrastructure in IDB member countries. Trade infrastructure development include the development of Energy, water, transportation (land and rivers), rural infrastructure, low cost technologies while Islamic trade financing infrastructure include the existence and empowered Islamic laws and regulations, suitable Islamic financing instruments and Islamic financial Institutions to provide full support to SMEs financing. Trade infrastructure and Islamic trade financing infrastructures are discussed in the following sub-section.

Trade Infrastructure Development in IDB member Countries

The quality and the development of the basic utilities such as energy, water, transportations (land and marine), warehouses, rural infrastructure, and low cost technologies are very essential for the Islamic trade finance. That is because the well-developed infrastructure enables SMEs to access trade financing and to promote business at low cost. The lack of the basic infrastructure facilities in any country create non-conducive trade environment, raise the cost and risk of trade financing and decrease the competitiveness of the SMEs. Moreover, Islamic trade instruments depend on the concept of buying and selling (Ba'i), which means in any trade activity the parties expect either movement or storing of goods until the possession moves to another party. Hence, the success of Islamic trade financing necessitates the availability of enabling trade infrastructure environment.

In order for Islamic trade financing to play a major role in developing SMES in the IDB member countries, more efforts must be exerted to improve trade infrastructure of the majorities of MCs particular through the involvement of the private sector. SESRIC (2012) reported that the private sector did not contribute in any energy project for thirteen of OIC member countries and transport infrastructure project for eighteen of them for the past twenty years (1990 - 2010)⁵.

Most of IDB member countries are having poor resources, civil wars, high political risks or high cost of unskilled labor to develop alone their trade infrastructure. In addition to that most of the government revenue of these countries is raised from tariff and tax which creates another trade barrier to the development of the SMEs. The nonexistence of encouraging climate to attract foreign direct investment or private sector to participate in the trade infrastructure development necessitates the intervention of IDB directly or indirectly through the recent innovated reverse linkages policy in the Member Countries Partnership Strategies (MCPS) introduced by the IDB in 2010.

Since many of IDB/MCs are not capable to develop their trade infrastructure without assistance from the more developed countries, the infrastructure development has been given high priority when IDB adopted its 1440H Vision. It represents one of the most important five pliers in the MCPS. A recent MCPS study showed that the weak over-land infrastructure, exorbitant transport costs and the high cost of financing and non-financial business services such as the administrative costs of doing business negatively affected the SMEs in Mali. Almost similar conclusion was indicated by the report of the related to Uganda MCPS ⁶. Hence, the undeveloped infrastructure

⁵ SESRIC (2012), Private Participation in Infrastructure in OIC Countries, OIC Outlook Series

⁶ IDBG Member Country Partnership Strategy for Uganda (2011 – 2015)

represent one of the major obstacles which hinder Islamic trade finance to play apposite role in the development of the SMEs in most of the developing IDB member countries.

Islamic Financial Infrastructure Development

In order for SMEs and other similar borrowers to have easy and smooth access to Islamic financing, IDB member countries required to develop an adequate Islamic financial infrastructure. There are many factors influencing the development of Islamic financial sector. Among these factors are efficient supervision, regulations, well trained Islamic banking professionals and shari'ah supervisors and shari'ah audits expertise. The previous evidence⁷ showed that impact of financial infrastructure on trade is not less than the trade barriers. Islamic finance cannot play vital role to promote the growth of the SMEs or even the prosperity of the larger Islamic corporations without favorable macroeconomic environment and better development of Islamic financial institutions.

Moreover, the affordability of Islamic financial instruments which to be discussed in the next section to the trade in general and SMEs in particular highly depends on the level of Islamic trade infrastructure. In order for Islamic trade financing to be effective and to have significant impact on the growth of the SMEs sector, IDB member countries need to provide enabling macroeconomic environment for Islamic trade financing by developing sound financial policies, good governance, and strong Islamic banking system.

Islamic trade finance access will be determined but not limited to the current trade performance of trade in IDB member countries, foreign resources, the degree of the indebtedness of these countries to the external parties, exchange rate policies and their legal environment. The current business performance of the IDB member countries is very essential for the development of Islamic trade infrastructure. The business performance might be determined by the level regulations such as labor wages, fiscal policies, inflation and uncertainty. There are a need for these countries to adopt very effective and inclusive Islamic legal framework which incorporate the accounting standards, corporate governance and bankruptcy law. IDB member countries have to develop Islamic legal and regulatory system to encourage promoting Shari'ah based trade financing system. The reality is that the majority of the IDB member countries either adopting conventional laws or mixed laws. The MCPS study for Turkey showed that the trade related regulatory factors such as the absence of specific accounting standards and the non-existence of the collaterals with the banking systems weakened the trade financing infrastructure and have negatively influenced the financial infrastructure, raise the risk of lending and prevent the SMEs from accessing finance in Turkey⁸.

The availability of foreign resources in form of FDI and grants would improve the level of domestic business, help in technology transfer, accessing large market and hence positively influence Islamic trade finance and improve the country competitiveness. The previous study found that most of the IDB member members are not strong in attracting enough FDI⁹. Dabour, (2000) recommended that policy decision must be taken to give more incentive to attract FDI to IDB member countries. Therefore, IDB member countries need to exert more efforts and implement reasonable measures to attract more external financial resources to improve Islamic trade financing infrastructures that lead to economic growth. The external debt also has negative impact on Islamic trade financing and has drained the local finance from most of the IDB member countries. The evidence has proved that the external debt represents one of the bigger challenges to the member countries. Hamour (2000) showed that large group of OIC countries faced serious problems with their debts as well as shortage foreign currency. The shortage of foreign currency deteriorates the value of the domestic currency and constrains the country's ability to import goods and services. Thus the severe external debts and shortage of liquidity in the poorest IDB member countries might indirectly constrain the development of trade finance and brought unfavorable business environment for the SMEs' growth. Furthermore trade financing will be influenced by the exchange rate policies. IDB member countries have to develop appropriate exchange rate policy for better Islamic trade financing climate. Overvalued exchange rate lead to a reduction in exporters competitiveness and hence their ability in accessing the foreign markets.

⁷ United Nations, International trade center (2005), Trade Finance Infrastructure Development Handbook

⁸http://www.isdb.org/irj/go/km/docs/documents/IDBDevelopments/Internet/English/IDB/CM/Publications/Partnership_Strategies/Turkey

⁹ IDB Annual Report 1425H, Economic Cooperation Among Member Countries, Chapter two.

In addition to the above IDB member countries also need to establish Islamic trade related intuitions to support Islamic trade financing in general and SMEs in particular. Many IDB member countries used to keep almost all the ownership of the trade related financial institutions if any such as export credit insurance and export- import banks in the hands of the governments. Moreover, some governments may use these trade-related institutions to regulate the trading sector and hence create additional hinders for Islamic trade financing to play appropriate role to promote SMEs.

The trade related institutions may also include central banks, ministries of finance and ministries of trade. The central banks promote Islamic trade finance through the tools of Islamic financing supervision and regulations that have been developed by the ISFB as well as through the regulations of the foreign currencies. Ministries of finance on other hand might play an essential role in Islamic trade development through providing tax incentives to encourage particular trade sector such as SMEs. Other similar trade related institutions which is likely influence the development of trade finance are the ministries of trade which are responsible for regulating and implementation of country's trade policies.

Based on the above argument one can say the development of strong Islamic trade financial infrastructure including Islamic trade-related financial institutions are very essential for the growth of the SMEs. . The current evidence showed the developed Islamic banking accounting standards, regulatory and suppressions standards, shari'ah audit and Islamic corporate governance's standards are need to be compulsory implemented by all the IDB member countries central banks and another trade related financial instruments need to be designed to promote SMEs and microfinance institutions . Hence, to achieve better Islamic trade financing infrastructure development, IDB member countries need to develop highly efficient and effective trade related institutions and strictly implement the ready developed Islamic financial supervision and regulatory standards. Finally the availability of highly qualified staff in these Islamic trade-related financial institutions, adequate skills workers and entrepreneurs might also represent one of the major factors influence Islamic financing infrastructure.

The Recent Trend of Islamic Trade Finance

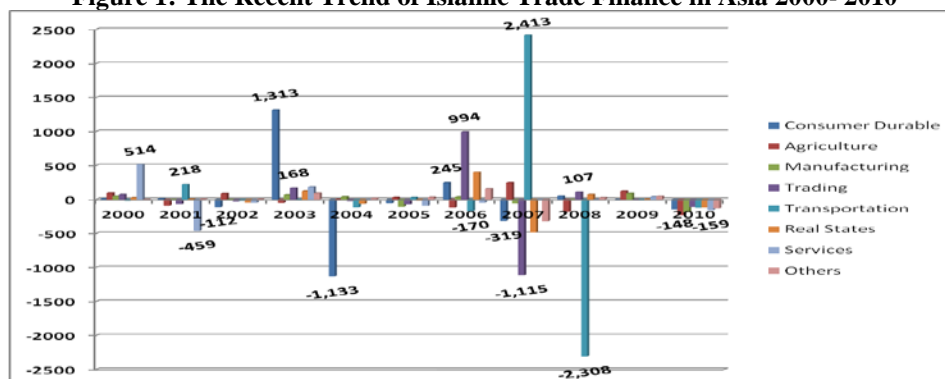
Islamic trade finance is a form of financing granted by banking based on Islamic legal concepts. It complies with the principles of Islamic Shariah law and promotes risk and profit sharing which replace fixed predetermined return. Almost all the available Islamic banks to some extent grant Islamic finance to corporate and SMEs trade activities. Due to the recent growing trend of Islamic banks in IDB member countries, more Islamic financing has been granted to different sectors. These sectors include consumer durable, agriculture, manufacturing, trading, transportation, real states, services and others. All these financed sectors it serve very vital areas for the Islamic trade finance either directly through financing the trading activities or indirectly through financing trade infrastructure development such as transportation and services sectors.

Despite the evidence attributed that Islamic were less affected by the recent crisis than the conventional counterpart in general, the financial crisis has great impact on the Islamic trading financing¹⁰. This shoed by analyzing the recent trend for Islamic trade financing for the period from 2000 – 2010 in all the three regions (Asia, Middle East and Africa) of the IDB member countries. It Islamic trade finance is the most affected among others sectors either during or posts the financial crisis dependence on the characteristics of each region.

Figure 1 showed that the Islamic trade finance grew negatively by more than 1000% during the financial crisis 2007 and is slowly recovered during the post financial crisis in 2008. This can be attributed to the closer linkage of the financial institutions in Asia to the Western financial institutions in many activities such export and import business other global financing.

¹⁰ Global Economic Crisis: Islamic Banks: More Resilient to Crisis? IMF Survey Magazine: IMF Research, <http://www.imf.org/external/pubs/ft/survey/so/2010/res100410a.htm>

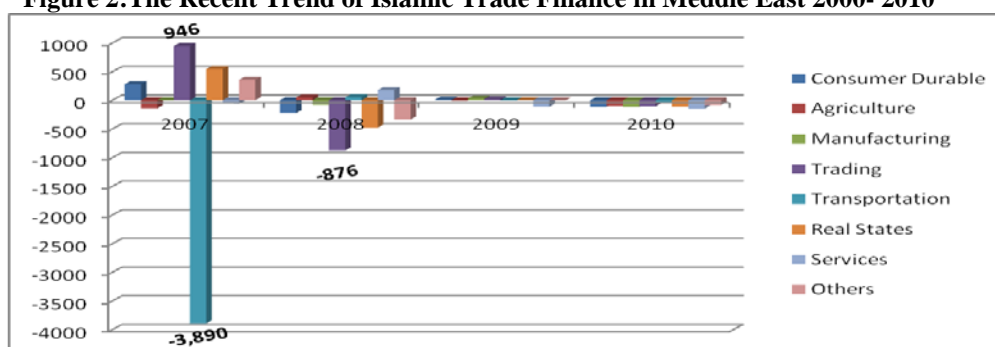
Figure 1: The Recent Trend of Islamic Trade Finance in Asia 2000- 2010



Sources: IBIS/IRTI

The global financial crisis also negatively impacted the Islamic trade financing in the Middle East region as shown in Figure 2. The Islamic trade finance dropped by more than 800% in the year 2008. The sharp declining in the Islamic trade financing in this region might attributed the post – financial crisis effect. This means that although Islamic banks resilience during the crisis but it has been impacted by the consequences of the crisis as shown by the trends. Likewise the consumer durable, manufacturing and the Real States are also negatively impacted.

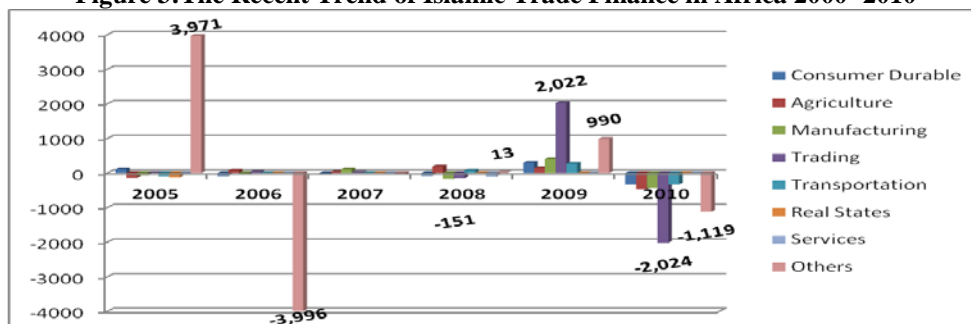
Figure 2: The Recent Trend of Islamic Trade Finance in Middle East 2000- 2010



Sources: IBIS/IRTI

Figure 3 showed the trend of Islamic trade finance in Africa for the period 2000-2010. As has been found in Middle East region, Islamic trade financing in Africa is negatively impacted during the post – financial crisis but less than that exist in the two others IDB regions. Islamic banks grant lower Islamic trade financing compare to the Asia and the Middle East regions during the recent financial crisis. This might be due to their lower scale and other challenges associate with their government polices and lower quality of trade infrastructures.

Figure 3: The Recent Trend of Islamic Trade Finance in Africa 2000- 2010



Sources: IBIS/IRTI

Challenges facing SMEs in IDBMCS

As has been discussed in the above argument the role of small and medium-size enterprises has become increasing essential for the IDB member countries prosperities. The World Bank recent

study has shown that SMEs become strategic tool for solving more challenges for the governments such as the competitiveness, unemployment, and raising the national income (Rocha R., *et al* 2011).

Despite of these positive roles, SMEs nowadays are facing more internal and external challenges. These challenges might not limit to the IDB/MCs and different from country to country, region to region and from firm to firm depending on the diversity of the environment in which SMEs exist. The most common challenges face the SMEs worldwide are those associated with the recent global financial crisis. The recent financial crisis has constrained the SMEs due to the shortage and high cost of funding. The lack of financial funding due to the lack of the liquidity during and post the financial crisis has prevented the SMEs from investing in assets for growth, innovation and research and development, which slowed its growth.

Another the most important challenges faced the development of SMEs in IDB MCs are the infrastructure development. As previous discussed the infrastructure represent the most critical element for economic growth and hence for trade finance in some IDB member countries.. The rail network the most cost-effective in-land transportation carries only 4% of the entire total cargo and the road transportation is not good as the railway. The high costs of transportation and energy lead to lower energy consumption particularly in the production, which also raise its cost and reduce the country's competitiveness. The improvement of the weak warehouse is a priority requirement for Islamic trade finance. Unlike the conventional the efficient Islamic trade finance cannot be effective without some type of infrastructure such as the warehousing. That is because many Islamic financing modes such as Salam, Muzar'ah, Murabahah, Mudarabah, etc. depend on financing the product in kind and not the same as the debt financing that exist in the conventional banking system.

The regulations and the effective implementation of trade rules are the third challenge facing Islamic trade finance for IDBG member countries. Trade rules and regulations are called trade facilitation which means the systematic rationalization of procedures and documentations for trade that minimize the transaction cost while maintaining an effective level of government control¹¹. The existence and efficient implementation of Islamic rules and regulations that associated with Islamic trade finance in general and SMEs in particular represent a big constraint for the IDBMCs. Fliess & Busquets C. (2006), found that the procedural barriers to trade such as arbitrary customs valuation, subjective interpretations, and arbitrary decisions of clearance goods through customs, technical barriers, laws and regulations regarding the various rules of trade represent one of the most obstacles for the development of SMEs in IDBMCs. Without more support and protection SMEs might exit the market under trade barriers let alone making profit. OKER (2002) showed that OIC member countries particularly those in Africa with vast land borders are lacking trade infrastructure and resources and accordingly they depend on high custom duties in their economic policies and developed extensive informal economic sectors. Therefore, to promote effective development of SMEs which proved to be very vital for the county's economic growth, IDB/MCs need to replace trade facilitation with the traditional trade control policies. Trade facilitation might help in eliminating trade barriers, bureaucratic and regulations that involve hindrances to trade and eventually constrain the development of SMEs.

Conclusion

This study investigated the challenges facing Islamic finance to promote the growth of SMEs in IDB member countries. SMEs represent one of the important drivers of the economic growth and an essential labor intensive sector that might help in reducing the high unemployment in most of IDB member countries. The results of the research indicated that Islamic finance facing more challenges in order to play vital role in IDB member countries. The weakness in the trade infrastructure development, trade facilitation and the unreasonable Islamic finance infrastructure have created unfavorable environment for the SMEs to grow and prosper. Accordingly SMEs in the IDB/MCs become less competitive due to the high financing cost, traditional trade policies, high tariff and tax, compared to international standard. While SMEs can be one of the best partners in the economic growth, provide more jobs and raise the standard of living in the member countries, both governments and IDB as a multilateral bank, need to exert more efforts to provide sustainable and enabling environment for Islamic finance to give effective support to SMEs.

¹¹ ESCAP, Trade Facilitation Handbook (2002), (www.unescap.org).

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THE CASE OF THE REHABILITATION OF “URBINO 2” DWELLINGS: A DEMONSTRATION OF THE NEED FOR INTERDISCIPLINARY COOPERATION BETWEEN CRIMINOLOGY AND ' BUILDING DESIGN'

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Abstract:

On the level of quality of life in the cities, street crimes play a relevant role because the safety of citizens is involved. It is a world-wide problem that is now increasing in relation to a number of factors, among them the new migrations, the level of maintenance of the towns, the level of community policing. The solution is of course a town designed on the basis of crime prevention through environmental design, and on this direction are acting some towns, for a limited part of them, due to the costs of the intervention.

The “Urbino 2” district lays at about 15 km from the town (and University) of Urbino, and was originated from planning mistakes of private builders and public administrations as well. As a consequence the only residents became non Cee people who could rent the apartments for very cheap prices, commonly living in greater number than allowed for the apartment or renting a part of it to other poorer people, thus reducing the value of the building, and putting the owners in the condition of being unable to pay for maintenance, and perhaps not willing to do. From a recent survey on a population of 600 persons only 10 are Italians. The district has become a real slum, where the different populations follow the rules and habits of their original countries, thus originating brawls, violence, aggressions and so on.

The paper shows the problems arisen in this incorrectly born district near Urbino, and the possibilities offered by CPTED design for its rehabilitation.

Key Words: Criminology, CPTED, urban rehabilitation

The interdisciplinary nature of criminology and the contribution of 'building design' strategies for crime prevention.

Criminology is, by its nature, an interdisciplinary science. The crime is a multifaceted and complex phenomenon, which is unleashed for a variety of different causes and that attacks the property and interests of the community at different levels and with different strategies, affecting the life, physical integrity, moral freedom, honor and property of the citizens. Therefore, the contributions offered in order to study, contain and reduce crime have always been among the most disparate. Have dealt with criminological issues not only lawyers, but also sociologists, psychologists, psychiatrists, biologists and even the statisticians and economists. A particular contribution, the usefulness of which is intended to explain in this essay, is offered by the so-called 'building sciences' architecture, engineering and urban planning in one word by 'building design'.

The collaboration between this group of subjects and Criminology began in the last century and takes its cue from the fact that the dynamics of the enforcement of the criminal not only detect the author's personal motivations and characteristics of the victim, but also the physical conditions of the environment in which the crime is committed. In short, in most cases, an individual already motivated to commit crime, will decide to actually commit the crime when the surrounding territory will offer real 'criminal opportunities': environmental configurations that allow easy access to the victim or to

access with little effort to the places where houses the well desired possibility of hiding that give the possibility to operate and ambush without being detected; with convenient escape routes .

From these empirical measurements, carried out in neighborhoods with high crime rates by sociologists of the Chicago School, comes a line of fruitful speculation about the relationship between physical environment and criminal activity, which is expressed in the reflections of June Jacobs in *'The Death and Life of great American cities'*¹² and the work of Ray Jeffery *'Crime prevention and control through environmental engineering'*¹³, and pushing the architect Oscar Newman to formulate the 'theory of defensible space'¹⁴, based on the idea of changing the structure of neighborhoods and the configuration of the buildings, in order to eliminate the 'criminal opportunities' and, indeed, to reverse the situation, planning and constructing the city in such a way as to facilitate the monitoring and control of the territory by the inhabitants.' The key criteria to be applied in restyling the city are those of the mixture of functions within the same district, the fragmentation of spaces for public use and private respected, to the extent possible, barriers to acoustic and visual, good lighting and care in the maintenance of urban land and buildings.

The thesis of Newman brilliantly passed the test of practical experimentation, since the actual crime statistics show a decrease in the crime rate in neighborhoods that the Architect had the ability to rearrange according to the criteria proposed by him, due to the sensitivity and the support of the Administration of New York. The trial continues, with the same success, also in other cities of the United States and new studies on the subject are added to the first.

Within the programs to-day referred to the acronym CPTED, is outlined, with particular importance, a trend that is concerned primarily to the rehabilitation of urban decay. In this regard appear exemplary direct interventions and then described by Wilson and Kelling in famous essay 'Fixing Broken Windows', related to the reorganization of the entire network of the New York City Subway and the recovery of urban areas at that time in the throes of decay, such as Bryant Park, which became, after the makeover, 'an urban jewel'. The authors of 'Fixing broken windows'¹⁵ insist on the need not to underestimate the decline, but rather to fight it immediately and incessantly since its early symptoms, because it is a potent precursor of urban crime. Act on the causes of the deterioration same means, in essence, to strike at the root of even the beginnings of such a crime.

In order for all categories of rehabilitation plans of urban space, are particularly significant modes through which these interventions are implemented. It is in fact a team effort - defined below as 'the work of participatory planning', because they are to be implemented through a collaborative effort between various social partners. Even the Chicago Area Project, agreed as the matrix of all programs of prevention through urban design, noted the need to involve in the rehabilitation of a 'criminal area' not only experts of crime and deviance - criminologists and sociologists - but also the people, government and, of course, planners, engineers and architects In this regard, the role of experts in the science of 'building design' is emerging as a fundamental step . In this category it is, in fact, the most important and demanding task of making feasible, the structural, technical and economic implementation of an abstract idea of the ideal city: a city light in his 'transparency', with no quarters of anxiety or devitalized, balanced in the interplay of services and public and private buildings, full of squares and green areas designed to unite rather than to separate. Again, the experts of 'building design' are responsible for determining, from more oriented solutions according to the criteria of 'defensible space'. those best suited to the particular case, and in relation to specific environmental conditions, both with reference to the budget available and the personal needs of users. This work of 'adaptation' plans for environmental remediation to the wishes of customers appears to be a decisive step to get to their acceptance by the private sector. In fact, not everyone may like to sacrifice his desire for privacy to the idea of 'transparency', a preference for small gardens green spaces that alternate with sidewalks along the streets, or have to endure, even in the evening hours, the animation and the buzz that comes from public houses interspersed with residential buildings. In these cases, the ability of the designer to find the most painless solution and provide it with aesthetic and functional components that make it attractive will still decisive.

¹² J. Jacobs, *The death and life of great American cities*, Vintage, New York, 1961

¹³ C.R. Jeffery, *Crime prevention through environmental design*, Beverly Hills, 1977

¹⁴ O. Newman, *Defensible space: crime prevention through urban design*, New York, MacMillan, 1972

¹⁵ J.Q. Wilson, G.L. Kelling, *Broken Windows*, The Atlantic Monthly, 1982

Soon, the CPTED programs are incorporated within that vast movement in favor of reconstruction, social and physical, of American cities, known as the New Urbanism. The movement, which was born in the most important American Universities, especially appreciates the social value of interventions. In fact, they do not simply make it more difficult the accomplishment of the crime by creating a material barrier - made with good visibility, elevated informal surveillance or anything else - including the potential criminal and his goal, but also produce the 'effect of increasing the population's sense of responsibility and sense of ownership of the land. Additional 'social' effects are those that are positive by strengthening the sense of propinquity and decreased sense of insecurity, arising from the restoration and the consequent 'repopulation' of public spaces - streets, squares, parks in earlier abandoned because of poor maintenance and gradual infiltration of deviant and criminal people.

Through the link represented by the United Kingdom, CPTED programs, are now arrived in Europe, albeit with a delay of several decades - corresponding to the lapse of time, because even on our continent took place the socio-cultural and economic transformation that led to the spread of urban crime. - The attitude shown by individual states and by the European Community does not appear, however, homogeneous, so that in many countries only recently began to resort to programs CPTED, while in many others, including Italy, it seems not fully comprised the real potential of the these methods, nor in terms of crime prevention, or in terms of the sociologic upgrading. Criminological science itself tends to flatten methods of prevention through urban design (CPTED) within the category of situational prevention to which without doubt they belong - neglecting the social value and confusing them with the means of mere mechanical prevention.. We often talk programs CPTED as a palliative compared to more effective methods or clinical social work aimed at the root causes of the criminal reasons, forgetting the opportunity presented by the application in the synergy of both types of interventions. Public authorities often fail to inform their choices to CPTED criteria, simply because they do not know them thoroughly. It is lacking, everywhere, a spread awareness among the general public, about the usefulness of specific design choices, such as lack as well, a group of engineers with specific knowledge on the subject being able to inform and 'form' users .

This deficiencies are probably the primary reason for the failure to implement its program in a law itself, by the European Union. Fact, there is not yet at the level of European Community legislation, a regulatory intervention giving CPTED criteria a binding value. They, in fact, have been incorporated exclusively within a system of 'pre-standards' for crime prevention through urban planning and design of buildings, prepared by the Comité Européen de normalization, European body responsible for the certification of quality ¹⁶ . This document is comprehensive and detailed and has the advantage of fully reflect the CPTED criteria adapted also to the European population, but unfortunately, being by its very nature, devoid of binding force, has the value of a proposal, the adherence to which is dependent on the good will and, especially, awareness of the recipients.

Is emblematic in this regard, the situation in Italy, in which we distinguish a few universities and public administrations 'virtuous' in the background of a general panorama of indifference and misinformation about the usefulness of the methods CPTED. All this takes place in a context in which the urban criminality and fear of crime are reaching worrying levels, while, in the meantime, poor choices in zoning and planning do aggravate the situation. The case of 'Urbino 2', which will be explained in the next section, illustrates clearly the terms of the problem, showing both issues: to which social and criminological continuation is a consequence of short-sighted planning policies, as well as what can - or better could be done- with an action applying serious and comprehensive CPTED methods, applied through the process of 'participatory planning' and the valuable support of planning experts, in the application of the criteria for removal and measurement of crime opportunities, displayed in the CEN norm.

¹⁶ For a detailed description of CEN pre-norms, see : R.M. Barboni, *Il ruolo dell'architettura e dell'urbanistica nella prevenzione situazionale ,all'interno delle strategie di contenimento della criminalità*, in *Città e criminalità*, edited by R.M. Barboni, Metauro edizioni , 2005

‘Urbino 2’ district: from a wrong urban choice to the possible solutions of the problem.

The Urbino 2 district is a typical example of the so called “Incorrectly born districts”¹⁷ In the specific case there was a fault of the Municipality of Urbino that planned a new district 15 km from the town, without providing any urban service, from bus to social and commercial services. The original goal was to create a students’ district and with this perspective it found builders aiming to gain a lot of money building little apartments (one or two rooms and WC) in an area of cheap lots. The mistake was due to the lack of services in situ and lack of transport facilities. Students never inhabited the district which quickly lost its value on the market. The consequence was the substitution by irregular citizens and a great percentage of immigrants; from a recent survey on a population of 600 persons only 10 are Italians

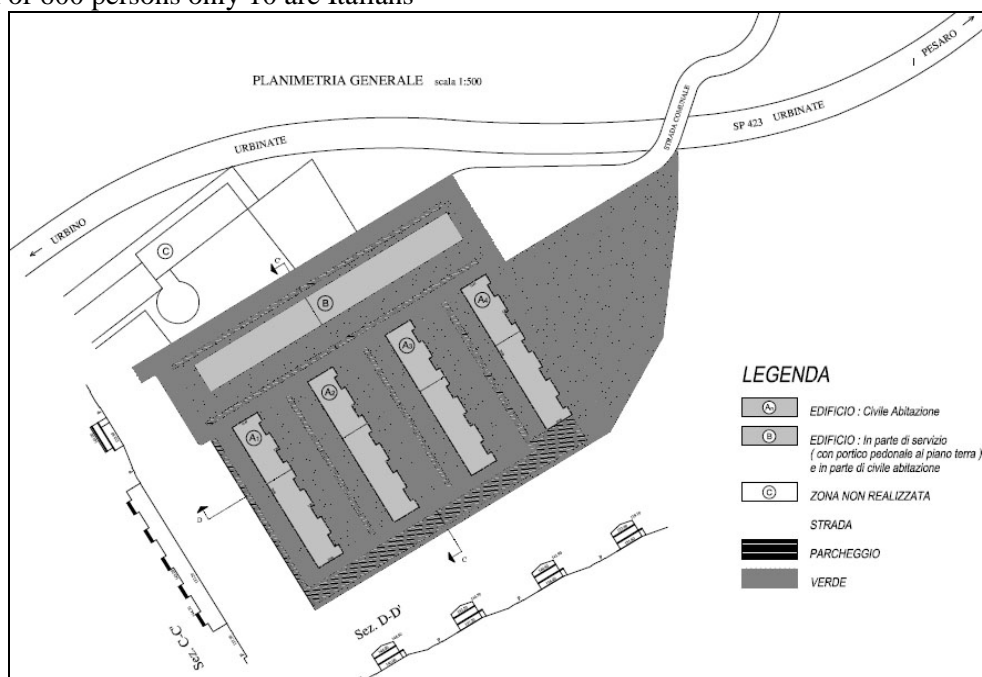


Fig 1: The original planning of Urbino 2 district around the year 1990

The district itself and even the external parts of the houses or the common parts of the apartment buildings became foreign and dangerous places in which people walks through speedy and do not stop (as said at Urbino 2 common people do not dare to enter). Relationships becomes rarefied, and in this district limited to groups of the same origin: north Africa Muslims, central Africa negroes, eastern Europe people, and so on. The way of life has become individualist and introvert. Everywhere we can assist at a particular phenomenon: people take some care of the inside of the houses (at their concept) but the outside part of the houses and the common parts in apartments buildings are totally neglected.

To give an idea of the actual level of life in the district we point out that a recent police action (100 policemen, drug dogs, an helicopter!) got the result to find out some illegal immigrants and to discover that on a population of 600 persons (compared with an authorized number of 120) only 10 were Italians. The district has become a real slum, where the different populations follow the rules and habits of their original countries, thus originating brawls, violence, aggressions and so on.

The intervention programs

In the last years the Province of Pesaro-Urbino is trying to carry on a rehabilitation program, but they are working only at urbanistic level without the advice of any criminologist. As a second step the planning of the intervention was entrusted to the ERAP (public housing institute). A first idea of intervention was simply to destroy the actual buildings, rebuilding a fully new district with different characters. The idea quickly resulted impracticable because several apartments were private

¹⁷ R. Montagna, R.M. Barboni, E. Montagna *Street crimes and quality of life in the neighborhoods* in: proceedings of XXXVIII IAHS Congress, Istanbul 2012

property of strangers who didn't have any other solution to live in. Nor could they be legally forced to sell out their property. Moreover destroying the district would have as an immediate consequence to find out an accommodation for about 600 persons, some of which minors without a family. A second negative factor came from a market enquiry that showed a very little request also for new buildings in this area, putting this type of intervention out of the market.

The solution was found out by the ERAP, asking to the actual residents who wanted to sell or was interested to an upgrade. The institute was able to buy (at really cheap prices) a great part of the apartments, and then as a major owner, to legally oblige the residual owners to participate to an upgrading program. In the few cases in which the actual owner could not participate economically, the ERAP offers the possibility to swap the apartment at Urbino 2 with an equivalent one, property of the Institute, elsewhere.

On this basis the public housing institute planned the upgrade of the buildings and in the meanwhile the Municipality planned an intervention on external common areas.

Goal of this paper is to evaluate the efficacy of both the plans in order to achieve a good CPTED level.

CPTED efficiency of the different options of intervention on the buildings

The upgrading process got through different planning options: at a first step the Province territorial office pursued the goal of integration with the surrounding buildings of the industrial area of a nearby municipality (Petriano); at a second step, as said, the total rebuilding was an option; finally the adopted solution was to upgrade the existing buildings.



Fig 2: shows the plan of integration with the surrounding buildings of the industrial area of the nearby municipality of Petriano

The alarming situation described above has been developed over more than twenty years: in the first instance, the owners as well as the local governments have completely ignored the warning on the need to counter the deterioration since its first appearance. Especially the owners preferred to save on maintenance work and pretended to ignore that the only users of the area – immigrants- filled up the apartments like animals, in order to be able to pay the rent required. On the other hand, the municipality of Urbino has for a long period 'forgotten' the area, ignoring the supply and maintenance of essential public services and failing to strengthen connections with the nearby town. So, after almost a century, it was possible to create a social disorganization at high risk of crime and deviance, very similar to that described in the 'classic' studies of the Chicago School.

Also subsequent attempts, aimed at curing the problem once it had exploded, were weak, uneven and inefficient. Initially it was attempted a sort of social integration, through interventions in social, often managed by the Volunteers destined from their beginning to a sure failure, due to the complexity of the critical area, and to a set of laziness, ignorance and lack of resources. Public

Administration though urged by police forces, by citizens' committees by articles of complaint in the local newspapers and by studies conducted periodically by the Department of Sociology and Law at the University of Urbino, failed to put in place a general rehabilitation program, as those suggested by CPTED methods, with the goal of a structural and social rehabilitation of the area through the involvement of all stakeholders and in collaboration with criminologists and experts in architecture, engineering and urban planning. It's clear, in fact, that in order to remove illegal immigrants and criminals from 'Urbino 2' a structural reorganization of the area was required, reorganization which, starting from a restoration of essential public services -lighting, sewerage, roads and degraded buildings- and passing through the construction of community centers such as shops, bars and sports areas, favored social integration, sense of belonging to the territory, self-empowerment and the activity of informal surveillance by the inhabitants themselves¹⁸.

Finally, in 2010, a turning point: a redevelopment of the neighborhood who finally analyzes the urban aspects of the matter and in which the need for involvement of different actors is taken into account. Things then move on to a "Memorandum of Understanding" signed by the towns of Urbino and Petriano, the Province of Pesaro-Urbino, by the regional office for public housing and by a cooperative of solidarity in DIY. Meetings are held between the public and residents, participating actively being sensitized to the problem. Yet the intervention has in itself the seeds of its own failure. In fact, the unique solutions provided, in order to restore the environment of the area, is the demolition of buildings that house more than one hundred families and a reconstruction based on criteria that include the transformation of the studios in bigger apartments, resulting in an actual reduction of receptivity from 76 to 46 apartments. An expensive solution that shows to be impractical. Demolition and reconstruction require to find, for a large number of people, housing, in some cases temporary housing, in other cases - who he will have to go forever? - definitive housing elsewhere. Moreover the cost of this type of intervention is evaluated in the order of 7 million euros for 76 apartments of medium surface of about 45 square meters!

As expected, the practical and economic difficulties, after a series of events that last at least two years, have the upper hand: the city of Urbino is forced to strongly reduce the project, including the discontent of the people who, in an open letter to local newspapers, denounce their situation of abandonment and the climate consequently arisen <that fostered attitudes contrary to the rules of public spirit>. Still, we could do more and better if in planning interventions had been involved criminologists and experts in the design according to the CPTED criteria. The identification of the minimum level of interventions needed to reduce the risk level, would in fact have led to the identification of proposals to restore the blighted buildings rather than demolish them and rebuild completely. In this regard it should be noted that an analysis of the project of reclamation of 'town of Urbino 2', carried out by the experts of the Polytechnic University of Marche¹⁹ in accordance with the scale of the risk assessment proposed by CEN tables, shows that the actions planned in relation to each building, were not sufficient to achieve a satisfactory level of risk reduction. 'Urbino 2', in essence, is an area that has served three times the consequences of misinformation on the part of all stakeholders - owners, public administration, planners, in order to programs of crime prevention through urban design. A first time, when you have not realized that building a new neighborhood without fitting of community centers and necessary infrastructure meant to condemning him, a second time when you chose to ignore the first symptoms of decay, preferring policy of profit maximization to that of a careful restoration of direct investment to maintain the decorum and, no matter how small, the market value of the property; finally a third time at the moment in which, even in setting up a comprehensive plan for recovery of the area has been omitted the use of a body of rules which, although not binding, could provide useful frameworks and suggest methods of restyling less radical and expensive.

Conclusions

It is true that 'Urbino 2' is not, in Italy, the only case of incorrectly born district: similar problems arose in other districts which sometimes got international relevance, as the famous district

¹⁸ R. M. Barboni, R. Montagna, *Abitare abusivo e criminalità, prospettive di recupero in ottica di prevenzione*, in: Scenarios of illegal dwelling, Luciano editore, Napoli 2007

¹⁹ R. Montagna, E. Pandolfi, G. Agarbati, *Rehabilitation of Urbino 2 slum- Criteria to upgrade the safety level in building design* in proceedings of IAHS Congress, Milano 2013

'the sails' of Scampia in Naples, also condemned the demolition. However, in some cases the choice of the government was more aware, as, for example, in the neighborhood Braida in Sassuolo in Modena²⁰, with a high concentration of immigrant population and in serious overcrowding and poor physical health and the buildings, marked by crime and incidents of social unrest. In this case, the clean-up, has been entrusted to experienced designers of CPTED, with excellent results. Seems particularly worthy of note the fact that, beyond the provisions for a few buildings in dangerous conditions, it is preferred to use the restructuring and maintenance, implementing also the offer of services and areas for recreational activities in order to increase the mileage and spontaneous surveillance. Therefore, it seems more and more desirable the formation of a 'common understanding' of the existence and the potential of a method for the prevention of crime which, if properly applied, has always given good results. This is a goal that calls at the forefront both the scientific experts involved, and the government authorities responsible for the safety and welfare of citizens, in order to study in more detail and then spread through publications, seminars, demonstrations and conferences, such a useful knowledge. Without a doubt, luck of these programs lies not only in their practical efficiency, but the effect is upstream of the crime problem and acts on warning signs of discomfort that leads to the crime itself. For this reason they cannot be collapsed into other situational prevention programs that are only mechanical.

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THE DECLINE OF THE CZECHOSLOVAK MARRIAGE AND THE ECONOMIC IMPACT OF THE VELVET DIVORCE

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Abstract

The article investigates differences in the transformation of Czech and Slovak economies and how these affected the overall economic development of the studied countries upon the dissolution of Czechoslovakia i.e. the Velvet Divorce. A contrastive comparison is embraced to grasp disparities in the transfer of one formerly centralized command economy with state-owned firms operating under the planned economy organization into two independent market economies under sovereign governance. Notwithstanding the common language and history, the Czech Republic and Slovakia underwent distinct transition processes crucial for the economic rise of the former and the development stagnation of the latter. The legal vacuum and the absence of strong monitoring over capital transformation on one hand, and a corrupted government and autocratic leadership on the other, ushered in scandalous privatizations with major Slovak firms depreciated and appropriated by small political elite without injecting capital or any significant restructuring of the corporate organization. The perpetuated growth of unemployment rates and fall in productivity illustrated by GDP decline, started to alarm for growing anomalies in the Slovak economic system as a whole, exhibiting ubiquitous distortions and a contiguous stagnation. These negative implications drew roots particularly from the imprudent economic policies of the first years of Slovak transition (1993-1998), until national elections had removed the first Prime-minister of independent Slovakia-Vladimir Mečiar from the Office. The Czech Republic led by Vaclav Klaus, meanwhile, benefited from a more responsible and democratic rule that put the Czech economy back on track and paved the way to its early integration within the EU market. Needless to say, the profiles of the first leaders of the independent republics of the Czechs and the Slovaks played an indispensable role in countries' overall progress or retrogression and their international recognition respectively. The main purpose of the article, therefore, entails an interdisciplinary identification of discrepancies in transition processes in the Czech Republic and Slovakia detrimental to the perpetuated and still observable disparities between the two countries in terms of economic development and standards of living.

Key Words: Czechoslovak marriage, velvet divorce, economic impact

As socialism and utopian concepts of equality, unity, and brotherhood began to crumble, a severe economic turmoil and uncertainty hit the former socialist countries right on the threshold of their long-sought independence. Amid national crisis and restructuring of borders, the common challenge of establishing an autonomous and functional economy came to be the principal and most pressing prerequisite for stable and sustainable development. Unfortunately however, the 75 years of inept and malfunctioning economic system significantly hindered the realization of countries' economic potential even in the years of transition and national sovereignty. What is more, in some countries this process of creation of prosperous economy was further impeded by the long history of dependency on the "big brother" country within the socialist family. Highly centralized economies and unequal industrialization heavily concentrated the capital in dominating states at the expense of the smaller and relatively underdeveloped sister-states. The latter served as resource centers deficient in financial investments with the exception of investments related to the production and supply of raw materials or final goods for the larger market of socialist empires. Although history abounds in such

examples, the case of Czechoslovakia and the later constitution of the independent Czech Republic and Slovakia deserves a particular attention. Through a brief contrastive analysis of the two states while in the Czechoslovak federation and a more elaborate examination of their independent transitioning to free market economies afterwards, this paper would outline the roots of the perpetuated and still observable disparity between the two countries in terms of economic development and standards of living.

A multifarious approach is nevertheless needed for providing a full insight in the reasons and causes of the ongoing discrepancies between the economies of the Czech Republic and Slovakia. Recalling the statement above about the peculiarity of the case of Czechoslovakia and its later dissolution, a particular focus needs to be put on the different paths each of the countries took after the so-called Velvet Divorce. The most striking differences were indeed right in the aftermath of the “divorce” up until 1998, a year particularly important for the Slovak nation. According to interviewees of a Slovak citizenship, Slovakia embarked on a “real” transition in 1998, after the national elections that removed the first Prime-minister of independent Slovakia- Vladimir Mečiar from the Office. The Czech Republic led by Vaclav Klaus, meanwhile, benefited from a democratic and responsible rule that put the Czech economy back on track and paved the way to an early integration within the EU market. Needless to say, the profiles of the first leaders of the independent republics of the Czechs and the Slovaks played an indispensable role in paving the way of countries’ overall progress and their international recognition respectively. In the spotlight of the disputes between the former allies was the issue of privatization which was approached in two divergent ways each of which will be discussed separately below. Inevitably, gaps between the Czechs and the Slovaks continued to widen and these will be illustrated by the two basic economic indicators: the rate of unemployment and Gross Domestic Product (including the level of GDP growth) alongside prospects of Foreign Direct Investments (FDIs). The timeframe of interest hereby stretches from the global decline of socialism (late 80’s-early 90’s) until 1998 i.e. the overthrow of Mečiar regime in Slovakia.

Slovakia’s pursuit for democracy and economic welfare, however, has its roots long before Mečiar’s era. The lack of geopolitical affirmation and the persistent threat of Magyarization (assimilation imposed by Hungarian authorities during the Austro-Hungarian monarchy) led Slovaks to seek preserving their identity by uniting with the Czech neighbors. From the very foundations of the socialist federation of Czechoslovakia, under the flag of equality and brotherhood, Czechs and Slovaks had been recognized as distinctly developed nations with an imposed superiority of the first over the second. As the first president of Czechoslovakia, Tomáš Masaryk himself put it:

There is no Slovak nation...the Czechs and Slovaks are brothers. Only cultural level separates them—the Czechs are more developed than the Slovaks, for the Magyars [Hungarians] held them in systematic unawareness. (Masaryk, 1934)

Slovaks grew to be greatly dependant on the Czechs who maintained political dominance throughout the entire existence of Czechoslovakia. The federation itself, particularly after World War II, shaped its status as a Soviet satellite state with a high influence and political control coming from the communist East. The Slovakian region that geographically was predisposed for a greater submission to and influence from the USSR, became the Soviet manufacturer and major supplier of arms and military equipment; another factor that added to the staggering unemployment rate and steep decline of industrial output during privatization in early ‘90s since the armament production technology was “not easily transferable to civilian production” (www.GlobalSecurity.org).

Whereas major Slovak production served the military purposes of the Soviet Union with industrialization and employment markedly reliant on the demand for arms and weaponry in the Soviet bloc, Czechs benefited from the relative exposure to Western markets, particularly notable in the relations between Germany and the advanced region of Bohemia. In return for the unequal regional development and highly centralized economy, Slovaks were regularly subsidized by their Czech “brother”. This, however, gave right to Czechs to claim higher representation thus greater amount of power in the federation. A unique dichotomy between Czech “sponsors” and “sponsored” Slovaks was developed as a result of unequal distribution of wealth and administrative power. Nationalist movements simmered among Slovaks with Vladimir Mečiar rising as people’s protector of nationhood and promoter of Slovakia’s status as an equal partner within the Czechoslovakian borders. Yet nationalist movements did not spur any ambitions for independence but a mere desire for equality

of representation aspired by the Slovak part. A poll conducted in 1990 in Slovakia attested that “only 16% of the population favored secession” (Bookman, 1994). Abby Innes further contends that indeed:

Mečiar was able to emerge as the most popular politician in Slovakia precisely because he came out against independence and took a centrist position between federalists and more radical nationalists. (Innes, 2001)

The issue of maintaining the federation and co-existing with Slovaks, on the contrary, was not of a primary concern of the Czech Minister of Finance and later Prime-minister, Vaclav Klaus. In the midst of the Prague Spring, Klaus was attending Cornell University where he was imbued with capitalist ideology of free and competitive market economy. Assuming position as Minister of Finance in 1990 and later becoming the Prime-minister of the confederative²¹ Czech Republic in 1992, Klaus intentions were to pursue radical and rapid economic reforms to the benefit of all. However, when privatization was called into question, Klaus was careful to observe that:

Privatization of the state-owned economy is not yet on the agenda. We cannot do it immediately; my colleagues would not agree to it. But we must put all forms of ownership on an equal footing immediately and let different types of ownership compete with the state firms. (Klaus, 1990)

Evidently, while advocating the “shock therapy” in most economic domains, Klaus took the gradual approach towards privatization as a means of both providing an incubator for the onset of sustainable and competitive private sector and a time interval for the creation and implementation of a rigid legislation that, according to Klaus, would impose “strict rules so that property is not sold by Communist managers for a low price. They often get payments under the table to sell to the first bidder” (Klaus, 1990). Additionally, when being attacked about the ignorance towards Slovak regional economy and lack of interest for attracting foreign investors interested in buying out Slovak state-owned factories, Klaus sarcastically went on to say:

They [Slovak trade union executives] asked me whether I would allow a money-losing, old plant in Slovakia to be sold to foreigners. I laughed and said, "Do you know what you are saying? A money-losing, run-down plant and a foreigner wants to buy it? We should be lucky if we find a fool in the West who wants to buy it and try to make it profitable. Everyone will benefit from that, except perhaps the Western investor." They had to agree. (Klaus, 1990)

And it was exactly when the economic system required transformation that Klaus' and Mečiar's trajectories diametrically diverged. While Klaus aimed at retaining some control over the process of privatization in Czechoslovakia in order to prevent “asset-stripping”, Mečiar's deep interest in privatization in the Slovak region was associated with concentration of political power. These basic disagreements in the political rhetoric between the two leaders of the Democratic Movements in the constituent Czech and Slovak regions of Czechoslovakia, gave grounds for the inevitable Velvet Divorce, or put in other words, the demise of Czechoslovakia and the creation of the independent Czech Republic and Republic of Slovakia on 1 January 1993.

The great challenge of replacing socialist planned economy with capitalist free market was differently approached by the new leaders of the now-independent republics. The ardent proponent of Milton Friedman's ideas on liberal market economy with minimum state intervention ushered in gradual but steady privatization, which by June, 1995 resulted in “80 percent of the economy [being] wholly or partly privatized” (Perlez, 1995). Referring to Klaus' speech in the Cultural Hall of Sokolov, Perlez in the *New York Times* cheers the pioneering feat of the Czech Republic as the leading post-socialist country in the stabilization of a deregulated economy:

Unemployment, at 3.3 percent, is the lowest in Europe. Inflation is 10 percent, one of the most moderate rates in the former Eastern bloc. And the country has a healthy budget surplus of \$400 million, the only Central European nation in this enviable position. (Perlez, 1995).

This speedy decentralization was achieved by implementing the model of mass privatization where 8.5 million Czech citizens were included in the bidding process. The Government served only as a mediator between enterprises and shareholders in order to make the process smooth, transparent, and effective. Government mediation also incorporated nationwide public information and general education about privatization, issuance of vouchers, the rights and roles of shareholders etc. The fact

²¹ By 1992 federation ties had loosened up transforming Czechoslovakia into a confederation which itself was precursor of the full disintegration into Czech Republic and Slovakia on Jan 1, 1993.

that “more than three medium-scale and large-scale enterprises, on average, per day” (Shafik, 1993) went from state to private ownership within a period of 14 consecutive months reflected the innate success of the program and its overall impact on the outstanding macroeconomic figures.

Clearly, the positive outcome steered a wave of Western investors interested in investing in the Czech Republic particularly injecting capital from the Netherlands and Germany. This interest was further increased with the Czech Republic’s accession to the OECD in 1995 with inflow of FDIs almost doubled from the preceding year; US\$ 4.546 million in 1994 vis-à-vis US\$ 7.350 million in 1995 (Milanovic, 1998). High level of solvency and an overall constructive economic performance granted foreign investors with sky-high return on investments. Parallel to this, international financial institutions were not reluctant to provide state loans much needed in the first transition years. What is more, according to the Czech National Bank report “all debts to the IMF were paid off in 1994”, four years before repayment was due. The Czech Republic was in full swing whereas its Eastern ex-spouse was not that fortunate.

Put in other words, Mečiar did not follow the steps of his former coalition partner Vaclav Klaus. By exercising an unprecedented power and abusing his supreme position, he engendered ubiquitous fear leaving Slovakia to toddle towards democracy and a better future. At the same time, Western criticism was interpreted as a pretentious interference in Slovakia with concealed capitalist attempts to hollow out its fragile and still vulnerable economy. Prospects for foreign direct investments were becoming more and more distant as privatization under Mečiar offered meager mechanism for securing property rights of the owners to be. Western investors like Westinghouse and Shell were soon driven out as the process of privatization proved to be lengthy and Slovak partners difficult to find. This type of systematically obscure and corruptive process “does not set a precedent for a market-oriented economy” (Green, 1996) as assessed by Jiri Huebner, the EBRD’s senior banker for the Czech and Slovak republics. Not only foreign investors but also international organizations such as the EU and NATO lost interest in Slovakia as demonstrated by their reluctance to add Slovakia on their member-state lists at the time.

For the situation to go from bad to worse, during the shift in governments in 1994, Mečiar managed to undertake also the role of Minister of Privatization and head of the Fund for National Property, both bodies designed to monitor and administrate the process of privatization. The New York Times reports that by running the Fund, Mečiar “handed cronies 52 major industries at bargain-basement prices in just one month” (The New York Times, 1994). Not only were the state-owned enterprises sold out at understated prices, but they were also acquired by elites close to Mečiar’s government as a reward for their loyalty. The favorable group of “winning” bidders included former ministers, party associates and members of their close families. When people who were only partially given the right to participate in the privatization process for later in 1994 to be denied of this right too (vouchers were banned in 1994 and replaced with long-term securities- bonds) called upon accountability and explanation from the authorities in charge, the spokesman for the National Property Fund Ota Balogh vigorously asserted:

We want to create a strong class of domestic entrepreneurs. We do not want control of strategic companies sold to foreigners. (The New York Times, 1994)

disguising real motives for accumulation of wealth and power in the hands of an autocratic ruler and his adherents.

Unavoidably, economic indicators started to alarm for growing anomalies in the failing system. In the same year (1995) when Klaus announced reduction of the unemployment rate to 3.3%, Slovaks had to struggle with 13.1%²² unemployed labor force, approximately 10 times higher than the unemployment rate in 1989 while still part of Czechoslovakia. The annual percentage of GDP growth in Slovakia of 5.8% almost tied up with the 5.9% of the GDP growth in the Czech Republic in 1995, yet Czech’s annual output per capita was US\$ 886 bigger than the same in Slovakia²³. Perhaps a more accurate indicator would be the poverty rate which increased by 1.2 in the Czech Republic and by 5 in Slovakia between 1989 and 1994 (UNICEF, 1995). Interestingly enough, Gini coefficient in Slovakia remained almost unchanged between the period of 1987 and 1994 ranging between 19 and 20 meaning that there was more equal income distribution rather than in other transitional economies.

²² World Bank World Development Indicators; downloadable from <http://www.worldbank.org/data/wdi/worldview.html>.

²³ GDP per capita (1995): Czech Republic US\$ 5,596; Slovakia US\$ 4,710. (Source: the World Bank)

Capitalism itself, however, naturally entails inequality in income distribution, such that was registered in all other transitioning countries including the Czech Republic with a Gini coefficient reaching 28 (Honkilla, 1996). Although stagnant Gini coefficient should not be perceived as a negative phenomenon, it clearly pictures the almost non-existent transition in Slovakia which, in the long run, would undoubtedly prove to be costly upon Slovaks and their economy.

In light of this brief yet graspable comparison between two emerging post-socialist countries, it is important to conclude that given policies at a particular time always bear with them long-term implications that can have stimulating or retarding effects on country's future development. The economic and political development of the Czech Republic and Slovakia throughout the 90's illustrates examples of both effects and invites current developing countries to learn from the lessons of their past. The two offsprings of socialist Czechoslovakia drew their own distinct destinies of success and prosperity on one hand, and apathy and backwardness on the other as a result of the former choosing reforms over stagnation and even greater isolation. Thriving Czechs easily overcome the painful process of transition whereas inert Slovaks fell in the pitfalls of a greedy and degenerated regime.

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PERSONALITY TYPES OF LITHUANIAN INDIVIDUAL INVESTORS

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Abstract:

Scientists explore investors' behaviour in financial markets for more than a century. Studies conducted agree that financial behaviour is the intersection of economics, psychology and sociology. Studies of investors' behaviour are important both to scientists and financial intermediaries, because investors' decisions influence not only well-being of themselves, but also the dynamics of financial market. In this paper recent researches in the field of behavioural finance are systematized. Based on M. M. Pompian methodology (2006) the study of Lithuanian individuals was conducted. The aim of this study was to determine personality types of investors. Research results showed that investors in Lithuania are rather thoughtful, but only six personality types (M. Pompian determines eight types) have been distinguished. It was found that Pragmatist Integrator Reflector, Pragmatist Framer Realist and Idealist Integrator Realist investors' types dominate in Lithuania.

Key Words: Behavioural finance, investors' behaviour, cognitive and emotional biases, investors' types

Introduction

The first scientific articles about irrational behaviour in financial markets appeared more than a century ago. G. Le Bon, French sociologist, was one of the first who observed these features. In his famous work (1896) he described "market impact" for individual decision-making process and found out that market sometimes encourages investors to act against their will, causing not only difficulties but also financial losses. However, financial behaviour as a science became especially popular after year 2002, when D. Kahneman was awarded the Nobel Memorial Prize in Economics for integration of psychological insights into economic science, especially concerning human decision-making under uncertainty. Hence, financial behaviour has become an integral part of finance and combines sciences of economics, psychology and sociology. Financial behaviour in financial markets not only determines financial well-being of individual investors but also has a huge impact on general dynamics of financial markets. Therefore, this problem attracts scientists' and market intermediaries', providing financial services to investors, attention in recent years. In Lithuania, however, these studies are fairly fragmentary, taking into account only researches of decisions of accidental investors groups. The research „Dimension of Individuals and Companies' Behavioural Finances“, funded by the Research Council of Lithuania is intended to make a detailed study of all investors in Lithuanian market and identify specific types of investors. This paper presents the results of individuals' (citizens) study. In addition this paper analyses theories of financial behaviour and their impact on investors' decision-making. The aim of this article is to identify types of Lithuanian individuals respectively investment strategies they use. Results of completed survey of investors are systemized using methodology suggested by Pompian (2006), in virtue of which authors of this article distinguish characteristics of Lithuanian investors and divide all investors into several types.

The Theoretical Aspects of Behavioural Finance

According to Shefrin (2001), behaviour finance is the study of how psychology affects financial decision making process and financial markets. Since psychology explores human judgment, behaviour and welfare, it can also provide important facts about how human actions differ from traditional economic assumptions. Raiffa and Raiffa (1968), Kahneman and Tversky (1979) noted that the behaviour of the individual in theory differs from practice, and classic financial models cannot

explain or predict all the financial decisions. Therefore, earlier and now the economic rationality of human being in its behaviour finance is criticized reasonably. Kahneman and Tversky (1979) ascertained that in practice household behaviour differs from theoretical behaviour. Households are intended to make financial decisions at their own discretion rather than on the basis of mathematical calculations. Kahneman and Tversky (1979) distinguish the following cases of incorrect perception of information (Figure 1).

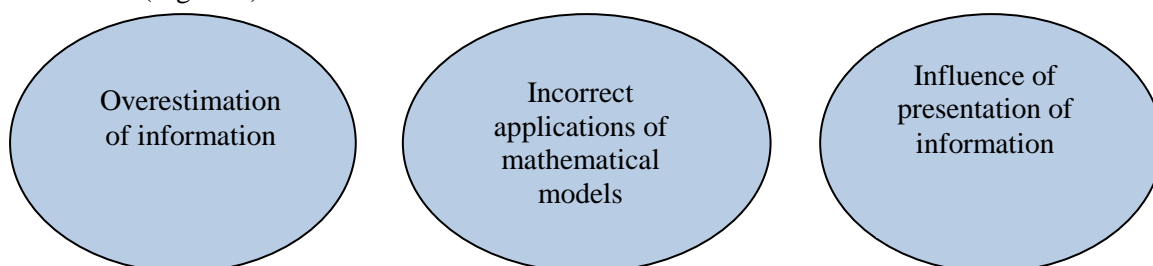


Figure 1. Possibilities of information indirect perception. Source: Kahneman, Tversky 1979

Overestimation of information means that participant of financial market makes decisions based on accumulated experience. In the other words, people are “framing” their decisions according to perception of past situations and ignore market factors that are really important. Mathematical models are often used in order to optimize financial security. They enable to evaluate the risk of securities, return of investment projects, policy of dividends, etc. However, not all mathematical models are universal; their application has some restrictions. As shown by Kahneman and Tversky (1979) not all market participants use mathematical formulas in order to assess real market situation. Moreover, information accession of market participants is affected by the way in which this information is presented. In other words, the way of presentation of information outlines primary assessment of information. Information in media as well as various visualization methods can structure this primary assessment of information for market participant. As a result the authors claimed that correct information about market situation can have both positive and negative effect on decision-making process of market participant.

Inquiries in behavioural finance were always related to individuals’ impact on the market and its instrument fluctuations. Jordan and Miller (2008) explained behavioural finance via individuals’ attitude and emotions in investment decision making process and market prices. Bodie *et al.* (2007) describe behavioural finance as a set of models of financial markets that emphasizes potential intervention of psychological factors into investor’s behaviour. Financial behaviour was widely studied by Sewell (2007), who made an overview of the development of this science and described the most distinguished scholars. Basic behavioural factors affecting investor according to Fischer and Gerhardt (2007) are: Fear; Love; Greed; Optimism; Herd instinct; the tendency to focus on the recent experience; the tendency to overestimate oneself and one’s knowledge.

Studies on financial behaviour are conducted in different countries in recent years. For example, Huei-Wen Lin (2012) analyzes interactions between types of individual investors (in Thailand), risk tolerance and deviation of crowd effect. An investigation showed that impetuous investors become herding, but rather be impacted by the mediator of risk tolerance. For the careful investors there is no significant reason to link their risk tolerance with herding bias. More anxious investors would possess lower level of risk tolerance which eventually leads to herding bias. But comparatively for the confident investors, they have higher level of risk tolerance and are less likely to form herding bias (Huei-Wen Lin 2012).

Chandra, Kumar (2011) analyzed the behaviour of investors in Indian stock market, especially psychological deviations, which affect decision-making process. Authors identified five related axes affecting individual India’s investors: prudence and precautionous attitude, conservatism, under confidence, informational asymmetry, and financial addiction. The results reveal some psychological axes, such as conservatism and under confidence. But the authors established some other – contrary behavioural axes reported by the multivariate analysis such as prudence and precautionous attitude and informational asymmetry which are not yet considered in other literature in growing economies. These psychological components look to be influencing individual Indian investors’ trading behaviour

in stock market (Chandra, Kumar 2011). According to Thomas, Rajendran (2012), financial intermediaries aim for investment pattern according to investor behaviour. In order to understand the investor behaviour, they must analyze the investor personality before offering investment plans. Hence, irrational decision making is determined by the factors of financial behaviour: cognitive considerations or considerations determined by feeling or emotions. Determination of these cognitive deviations and emotional dispositions helps to understand how they can be effectively neutralized. In order to identify them properly, these factors must be distinguished first.

According to Pompian (2006), cognitive deviations are the key statistical, information processing or memory deviations, which determine irrational decision-making. The emotional dispositions are determinants of irrational decision-making, but affected by provisions, feelings and emotions. Cognitive deviations could be removed easier than emotional. Cognitive deviations arise from incorrect reasoning, and better information or simple correct advice can reduce or totally eliminate these deviations. Whereas emotional dispositions arise from impulse or intuition and can lead to non-optimal decision-making. In this case, emotional dispositions can only be recognized and adapted. Thus, cognitive and emotional differences can help to determine when and how to adapt financial behaviour dispositions in financial decision making. Ritter (2003) explains financial behaviour through two main blocs: cognitive deviances and arbitrage restrictions. Others summarize researches of behavioural finances hypothesis of subjective irrational behaviour into two groups: theory of cognitive deviations and prospect theory (Jurevičienė, Ivanova 2012).

Methodology of Identifying Types of Investors

To identify types of Lithuanian investors Pompian (2006) methodology is used in this study. The empirical study was conducted in September-December 2012. 384²⁴ respondents were interviewed. The results of the study compared with the results of other authors' studies, investigating financial behaviour of Lithuanian investors, in order to determine deviations of behaviour and factors and causes of such deviations. Respondents were given a questionnaire consisted of three parts.

The first part of the questionnaire was designed to identify respondent's profile. In order to determine respondent's profile such criteria like gender, age, education, occupation, monthly income and assets were used.

The questions in the second part of questionnaire were designed to identify whether a respondent saves and what are the saving motives. In addition, respondents were asked to determine the amount of money which they allocate for saving per year, and if they invest.

Last – the third – part of the questionnaire was designed to determine investor's behaviour and identify predominant type of Lithuanian investors. This part of questionnaire was intended only for investing respondents.

During the study 147 respondents indicated that they are carrying out financial investments and agreed to participate in further part of investigation (to determine investors' behaviour and type).

M. M. Pompian identified three investors' personality dimensions:

²⁴The size of sample can be calculated according following formula (Schwarze, 1993):

$$n = \frac{N \times 1,96^2 \times p \times q}{\varepsilon^2 \times (N - 1) + 1,96^2 \times p \times q} \quad \text{where: } N - \text{size of population; } p - \text{probability that certain attribute is present in population; } q - \text{probability that certain attribute is not present in population; } \varepsilon - \text{level of precision (probability of error).}$$

According to Lithuanian Department of Statistics, there were 3 007 758 citizens in Lithuania in 2012. However, individuals under 20 years old must be eliminated, because they usually do not invest. As the number of individuals under 20 in Lithuania in 2012 was 2 357 698, so $N = 2\,357\,698$. To determine p the probability of the worst option is used, that is 50%. Hence, $p = 0.5$.

Since $q = 1 - p$, so $q = 1 - 0.5 = 0.5$.

Level of precision ε (probability of error) usually is chosen 0.05, or 5 percent. So in order to clarify investment behavior of individuals in Lithuania, 384 respondents should be interviewed:

$$n = \frac{2\,357\,698 \times 1,96^2 \times 0.5 \times 0.5}{0.05^2 \times (2\,357\,698 - 1) + 1,96^2 \times 0.5 \times 0.5} \approx 384$$

- Idealist (I) versus Pragmatist (P);
- Framer (F) versus Integrator (N);
- Reflector (T) versus Realist (R).

The environment of types of investor is illustrated in Figure 2.

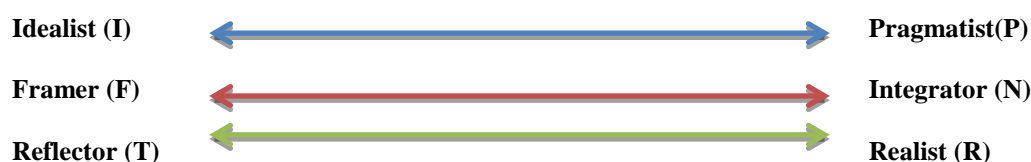


Figure 2. The investor personality types environment. Source: Pompian (2006)

According to M. M. Pompian, individuals with dominant idealist type overestimate their own, as an investor, opportunities, assess financial markets too optimistically and do not trust information which contradicts their point of view. They overestimate own investment abilities and often are enamoured of speculative activities in the market and fall a victim of such market. Idealists are characterized by following deviations: excessive optimism, accessibility, illusion of control, authentication, novelty testing and representativeness. M. Pompian (2006) points out that cognitive deviations by which idealists are characterized are excessive self-confidence, availability/appropriateness, attribution, illusion of control, authentication, novelty, representation and emotional – optimism.

Pragmatists perceive their investment skills and limits realistically. They do not overestimate financial markets and critically evaluate their abilities and understand that investment is stochastic process. They carry out researches to support their beliefs. This type of investor does not have many deviations.

Framers tend to evaluate each of their investment separately, but do not estimate how particular investment correlates with investment portfolio. Framers are distinguished by specific cognitive deviations: anchoring, conservatism, mental accounting, framing and avoidance of uncertainty.

Integrators are characterized by holistic thinking and ability to evaluate their investment portfolio in broader context. They understand that investment portfolio must be managed as a system, the components of which can interact, complement and balance each other. Integrators understand the importance of correlation between different financial instruments and take it into account creating their investment portfolio. They flexibly adapt to fluctuations in the market and changes in securities' prices.

For reflectors it is difficult to outlive the consequences of their decisions and it is difficult for them to act in order to correct their inappropriate behaviour. They justify and rationalize their wrong actions and are hesitant to admit their mistakes. Reflectors are better characterized by emotional deviations: avoidance of loss, endowment, self-control, regret, current situation. Cognitive deviations – alleged prediction and cognitive dissonance – may also occur.

Realists are easily reconciled with negative consequences of their decisions. They are not tended making excuses and they take responsibility for their mistakes.

M. M. Pompian argues that deviations are characteristic of only three types of investors: idealists, framers and reflectors. Deviations of these types are described in Table 2.

Table 2. Biases of investors' types. Source: Pompian (2006), Bikas, Kavaliauskas (2010)

	Bias	Explanation
Idealist	Overconfidence	Unjustified confidence in individual decisions and cognitive abilities.
	Availability	Probability is calculated on the basis of past experience.
	Self- attribution	Individual assigns himself successful experience, successful events.
	Illusion of control	Person believes that an ultimate outcome is in his hands.
	Confirmation	It is a variation of selective perception when ideas that confirm individual beliefs are highlighted, emphasized. Everything that is contrary to individuals beliefs is underestimated.
	Novelty	It is a tendency to remember new observations more frequently when information received earlier.
	Representation	New experience is contributed to absolutely different experience (as it is).
	Optimism	Individual does not see facts and reality, when future, events and decisions is evaluated too optimistically.
Framer	Anchoring	Individual imagines some kind of initial value (anchor) and adapts his decision to that value.
	Conservatism	Individual adhere his previous opinion or prediction without paying attention to new information.
	Mental accounting	Tendency to encode and evaluate economic results by grouping assets into various irreplaceable mental accounts.
	Framing	Tendency to make decisions according to the situation is shown to him at that moment.
	Ambiguity	Individual hesitates in situations of uncertainty, ambiguity.
Reflector	Loss aversion	Individual feels stronger impulse to avoid loss than to earn profit.
	Endowment	Individual evaluate a particular asset more if he has the right of disposal (for example, owns it).
	Self-control	Individual consumes today at the expense of tomorrow.
	Regret	Individual does not take crucial decisive actions because he is afraid that any decision will still be non-optimal and inadequate.
	Status quo	Individual is predisposed to choose any solution that confirms existing conditions (status quo) instead of other alternatives that would bring changes.
	Cognitive dissonance	New information usually contradicts to earlier individual perceptions what leads to mental discomfort.
	Hindsight	After certain events individual believes he already knew that these events would happen.

M. M. Pompian identifies eight personality types of investors in his studies:

IFT – Idealist Framer Reflector; IFR – Idealist Framer Realist; INT – Idealist Integrator Reflector; INR – Idealist Integrator Realist; PFT – Pragmatist Framer Reflector; PFR – Pragmatist Framer Realist; PNT – Pragmatist Integrator Reflector; PNR – Pragmatist Integrator Realist.

The profile of respondents

222 women and 156 men participated in the study of investors in Lithuania (six respondents didn't indicate their gender). 58 percent of all respondents belong to the age group 20-39 years, 6 percent of respondents are older than 60 years. Major part of participants of the study (40 percent) were individuals with average monthly income. 8 percent of all respondents were individuals whose monthly income exceeded 6000 Lt²⁵. Respondents distributed more or less equally by assets managed.

²⁵ 1 euro equals 3,4528 litas.

91 percent of all respondents had higher education, 61 percent were employed workers, and 14 percent participants of research were business owners. The results of research revealed that major part of respondents save (295), but only 144 respondents make household budget and only 137 have a financial plan.

Typology of Lithuanian Individual Investors

Analysis of results revealed that most of respondents are from Pragmatist Framer Realist (27) and Pragmatist Framer/Integrator Realist (31) type of investor behaviour. The type Pragmatist Integrator Realist correspond almost equally men (11) and women (9). According to Pompian (2006), the decisions of individuals of this type are not or are almost not affected by any behavioural biases. Pragmatist Framer Realist and Pragmatist/Realist types of investor behaviour are most popular among female respondents.

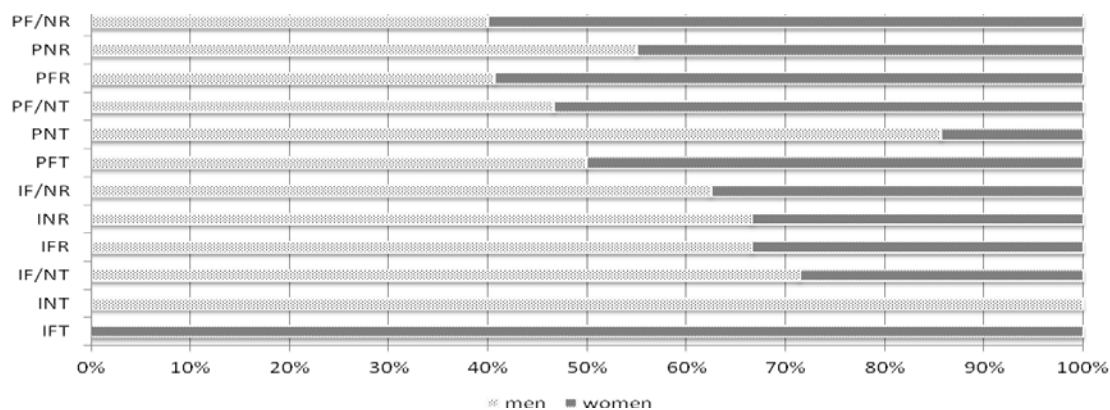


Figure 4. Types of behaviour by gender. Source: composed by authors, based on data of empirical study

Analysis of behaviour types by age revealed that Pragmatist Integrator Realist type is typical for respondents 40-59 years old. This suggests that elder individuals, possibly having investment experience, behave quite rationally and their investment decisions are not influenced by behaviour biases. Idealist Framer Reflector personality type is typical only for respondents in age group 20-29. This type is characterized as having all possible behaviour biases. It can be stated that young investors have no investing experience and more rely on a variety of opinions than on rational behaviour. However, it is noticeable that dominant type of this age group is Pragmatist Framer Realist. The key biases which this age group respondents face with are: inability to choose investment asset which could complement and diversify investment portfolio.

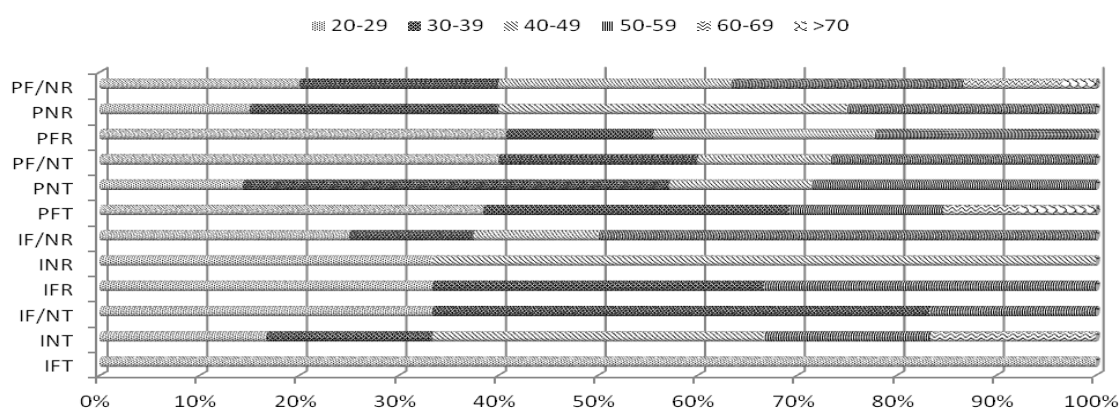


Figure 5. Types of behaviour by age. Source: composed by authors, based on data of empirical study

Monthly income of respondents, in fact, has no significant impact on type of investor. However, it should be distinguished that among investors with monthly income 1500-4000 Lt are Pragmatist Framer Realist and Pragmatist Framer/Integrator Reflector types are dominant.

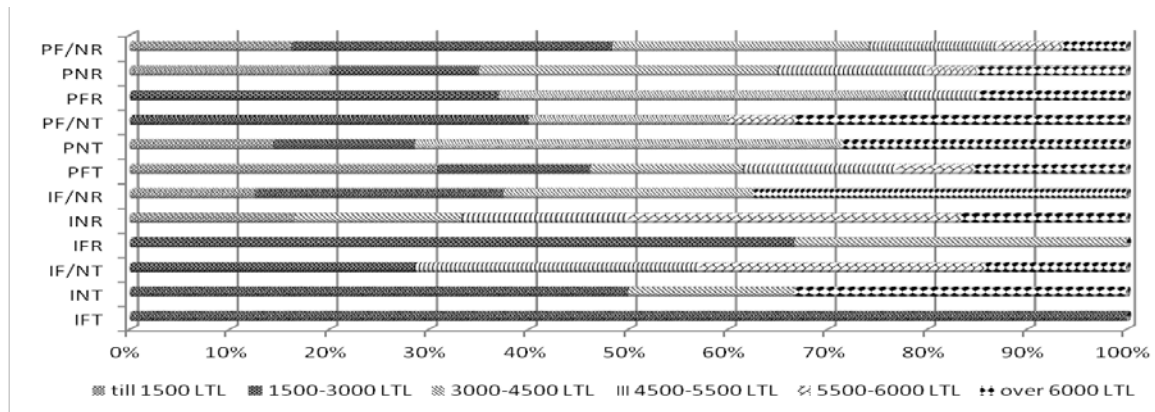


Figure 6. Types of behaviour by monthly income. Source: composed by authors, based on data of empirical study

Analyzing distribution of respondents by type of activity it is seen clearly (Figure 7) that characteristics of Idealist-Framer-Reflector are specific only to employees. Business owners usually have features of Idealist-Integrator-Realist and significant part of owners has Pragmatist Framer/Integrator Reflector features. Public servants have most characteristic features of Idealist Framer Realist type.

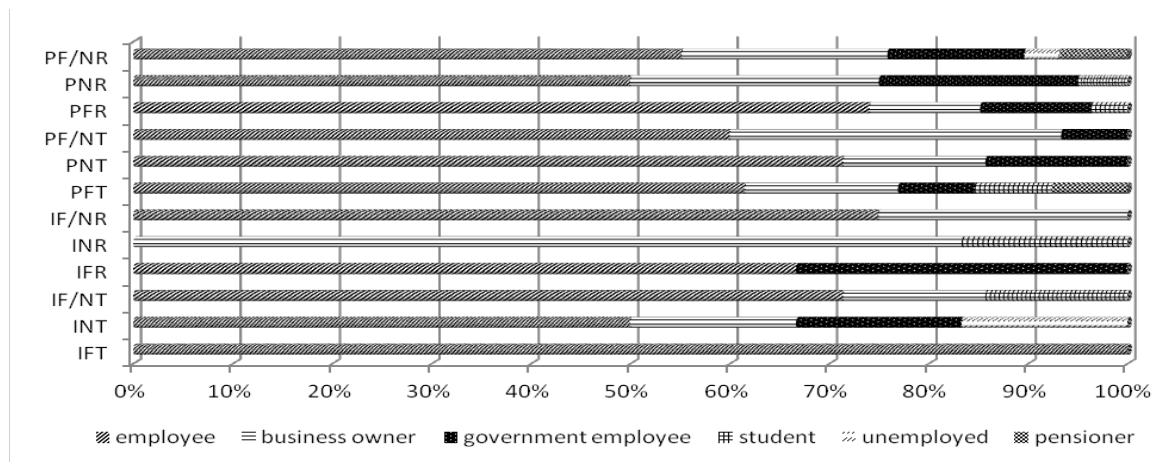


Figure 7. Types of behaviour by occupation.

Source: composed by authors, based on data of empirical study

Individuals' with higher (university) education investment behaviour is distributed through all types of investors. However, major part of respondents belongs to types Pragmatist Framer Realist (23) and Pragmatist Framer/Integrator Realist) (27). It should be noted that Pragmatist Integrator Realist type (without behaviour biases) is specific to respondents who have only secondary education as well.

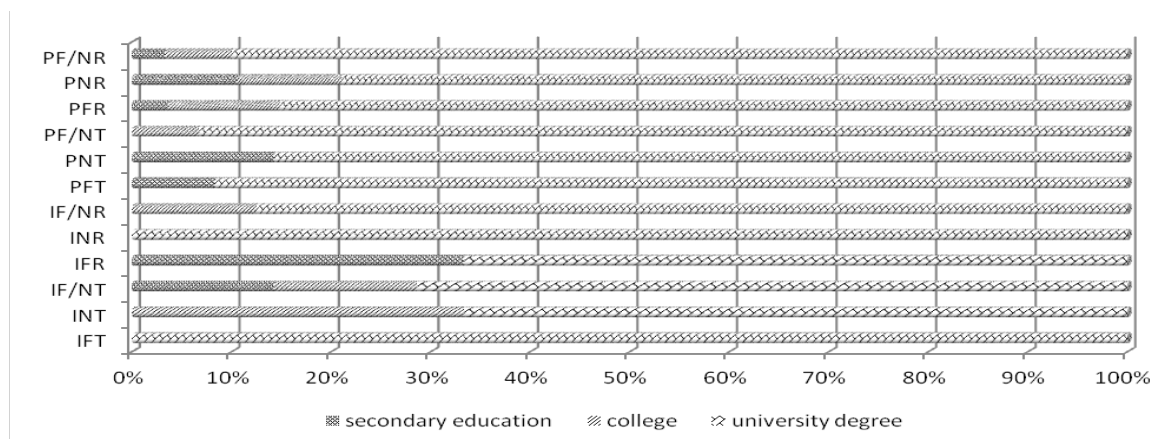


Figure 8. Types of behaviour by education. Source: composed by authors, based on data of empirical study

Concluding the study it can be stated that investors in Lithuania have quite realistic way of thinking, but majority does not comply with eight M. M. Pompian’s types (Figure 9). 21 percent of respondents are between: Idealist Frammer/Integrator Reflector; Idealist Frammer/Integrator Realist; Pragmatist Frammer/Integrator Reflector. 21 percent of respondents distributed equally between Pragmatist Frammer and Integrator Realist.

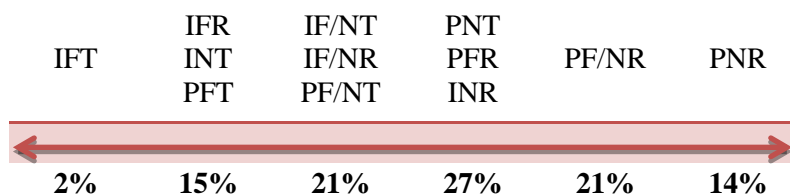


Figure 9. Respondents’ distribution behaviour type. Source: composed by authors, based on data of empirical study

When comparing results with previous studies under similar methodology (Bikas, Kavaliauskas 2010 and Jurevičienė, Jermakova 2012) it is seen that during the crisis the behaviour of investors was distributed fairly equally between Idealist Frammer Realist, Idealist Integrator Reflector, Pragmatist Frammer Reflector – 39 percent and Pragmatist Integrator Reflector, Pragmatist Frammer Realist, Idealist Integrator Realist – 40 percent, which means that 53 percent of respondents are rational, partly resistant to emotions, demonstrating rational behaviour with some irrational impurities and totally irrational investors – 47 percent; the behaviour 13 percent of Lithuanian investors is not related with irrational behaviour at all (Bikas, Kavaliauskas 2010).

IFT	IFR INT PFT	PNT PFR INR	PNR
8%	39%	40%	13%

Figure 10. Lithuanian investors’ distribution by behaviour type (Bikas, Kavaliauskas 2010)

Jurevičienė, Jermakova (2012) have conducted a study according methodology presented by M. M. Pompian in 2008 (Pompian 2008). In this methodology M. M. Pompian has associated previously mentioned patterns with factors of financial behaviour and determined four (BIT’s) types of investors: Passive Preserver, Friendly follower, Independent Individualist and Active accumulator. Jurevičienė, Jermakova (2012) discovered that in general Lithuanian residents are characterized as friendly follower investors. Such investor type is characterized by:

- Passive investing and having no own investment ideas;
- Being in the track of friends and colleagues, herd instinct;
- Tendency to agree with meaningful-looking proposals;
- Choosing of popular investment instruments regardless to and long-term plan;

- Overestimation of risk tolerance.

Friendly followers are passive investors who usually do not have their own investment ideas and, in most cases, follow the example of friends or colleagues in making investment decisions, and, finally, choose the most popular investment strategies despite of long term plan. Ionescu et al. (2009) called this phenomena herd feeling. Herd feeling occurs when an investor takes over other investors' strategies because one believes that information obtained from others can help them to make better investment decisions. Moreover, friendly followers are also characterized by the fact that they constantly overestimate risk tolerance. Therefore, finance advisers should be careful when offering popular strategies, because customer may agree to invest in all of them. Financial decisions of friendly follower are determined by cognitive biases: templates, propensity for innovations, cognitive discrepancies, dislike of ambiguity.

Conclusion

Irrationality in behaviour of investors has been observed more than a century ago, despite that researches in this area are still popular, especially in recent years, when dissemination of information has intensified. Various authors in different countries are trying to identify the most typical personal features that determine investment choices. These researches are very important for financial intermediaries, directly serving customers by advising to choose one or another investment facility.

Cognitive biases and emotional factors leading to different investment decisions are usually mentioned in the researches. However, some authors additionally distinguish as separate group's - limitations of arbitrage and prospect theory, which affect irrational choices.

This paper analyzes individual investors in Lithuania and identifies their personality type according to methodology of M. M. Pompian presented in 2006. The results of study showed that investors in Lithuania have quite realistic way of thinking, but majority does not comply within eight types identified by M. M. Pompian's. 21 percent of respondents are between: Idealist Framer / Integrator Reflector; Idealist Framer / Integrator Realist; Pragmatist Framer / Integrator Reflector. 21 percent of respondents spread equally between Pragmatist Framer and Integrator Realist.

Comparing these results with other studies under similar methodologies, it can be stated that during the crisis the number of investors of types Idealist Framer Realist, Idealist Integrator Reflector, Pragmatist Framer Reflector decreases more than twice (from 39 percent in 2009 to 15 percent in 2012), and the number of investors of types Pragmatist Integrator Reflector, Pragmatist Framer Realist, Idealist Integrator Realist decreased less than twice (from 40 percent in 2009 to 27 percent in 2012).

Hence, it was not possible to identify two types among Lithuanian investors ascertained by M. Pompian because answers in presented investigation distributed equally.

Acknowledgements

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FACTORS AFFECTING VALUE ADDED TAX REVENUE

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Abstract:

This article examines the concept of value added tax, the notion of the tax, the EU directives governing the tax rate base as well as the change of standard rate in European Union countries. The paper also analyses the relationship between the VAT revenue and macroeconomic indicators: gross domestic product, gross domestic product per capita, consumption expenditure, household consumption expenditure, government consumption expenditure, export, import and unemployment in the country in an attempt to construct a model that describes the significance of VAT revenue collected. The article aims to analyse the key factors influencing value-added tax collection in the European Union countries.

Key Words: Value added tax, VAT rate, VAT revenue and macroeconomic indicator

Introduction

The state revenue that consists primarily of tax revenue is the main mechanism for ensuring economic development. Fiscal policy not only controls the global factors affecting the national market and the economy but also it becomes the interior guarantee ensuring social development of each particular state.

One of the most important elements of the tax system is a value added tax. Value-added tax compared to the other taxes in terms of the part of budget revenue is one of the major taxes comprising the largest part of tax revenue of the state budget. In case of cyclical fluctuations of the economy, it is the system of value added tax that is primarily used to stabilize state revenue and to ensure the performance of public functions. This is confirmed by the recent economic and financial downturn. Value added tax burden triggered by the pricing system is transferred to all consumers, regardless of their legal status, solvency possibilities or other factors. It is an important factor influencing the state competitiveness. Value added tax efficiency that involves the collection of the biggest possible revenue for public budgets without significantly affecting the economy or one of the industries or groups of consumers is supported by the fact that the VAT is widely spread among different countries. Given the fact that this tax affects the development of the internal market without borders, the procedure of charging this tax is strictly regulated in the European Union. In addition, in order to avoid price differences to consumers and opportunities to provide exceptional advantages to a single national market, value-added tax is given special attention.

The scientific literature provides various analyses of tax systems. The significance of value-added tax to the economy is recognised, yet this tax is usually analysed only in terms of the tax rate, the tax exemptions and VAT thresholds. Also, the literature presents the value added tax analyses of individual countries and VAT comparison to other taxes, but the value added tax that is functioning in the European Union has not yet been analysed or comparison of value added tax systems of different European Union Member States has been conducted, though a great focus on VAT harmonisation is visible. Value added tax harmonisation process started on establishing the European Community and is still going on. This is a long and complicated process. So, it is important to reveal the differences of the impact of value added tax systems of the European Union Member States on collected revenues as well as the factors that affect them. The calculations were made with Microsoft Excel software using CORREL, TINV, FINV and Data Analysis functions.

The concept of Value Added Tax (VAT) in the European Union

VAT - an indirect tax levied on the public and private consumption. This tax is paid by corporations even though the tax burden is shifted to consumers (Bendikienė, Šaparnis, 2006), as manufacturers and service providers include it in the price (Dilius, Kareivaitė, 2010).

Goods and services are commonly charged with VAT aiming to collect as much funds into the state budget as possible. The VAT administration is not complex and relatively cheap. VAT is a key element of the tax system, which is a significant and important source of revenue in many states. According to the VAT scheme, the added value is created in each phase of the manufacturing process, so that each phase brings revenue to the state budget (Bendikienė, Šaparnis, 2006). VAT is introduced at the beginning of manufacturing process and is counted in each phase of product or service production and marketing until it reaches the consumer, who pays this tax (Štreimikienė, Mikalauskiene, 2006).

Value-added tax is collected after the final consumer prices are imposed, but does not affect the production or distribution (Dilius, Kareivaitė, 2010). On the other hand, VAT is a regressive tax, because in terms of the same consumption, people with lower income spend a larger part of their income rather than those with higher income (Jenkins et al., 2006).

The European Economic Community first regulated this tax in 1970 by the First and Second Directives. In 1977, the introduction of the Sixth Directive paved the ground for VAT harmonisation in the EU Member States (Marian, 2008). The objective of VAT regulation in the Community was to create an internal market in which the import and export taxation was abolished for intra-Community trade as well as the cumulative effect was eliminated which is defined as production and consumption taxes between Member States.

The EU countries apply a standard VAT rate which is imposed by each Member State as a percentage of the taxable value and which must be equal to the supply of goods and services. The Council's Directives state that "seeking that the increasing differences of the standard VAT rates applied by the Member States do not affect the EU structural balance and to avoid distortions of competition disruptions of some activities, in the area of indirect tax minimum rates are adopted", (Council's Directive 2010/88/EU). This minimum rate principle is also applied to the value added tax, as the most significant indirect tax. On 28 November 2006 the Council adopted Directive 2006/112/EC that regulated a common system of value added tax and determined that the standard VAT rate may not be less than 15 percent. At this point, according to the Directive 2010/88/ES adopted by the Council on 7 December 2010, this rate regulation is valid until 31 December 2015.

The minimum permissible EU VAT rate over the period of 2004 – January 2013 was applied in three states: in Luxembourg – the entire period, in Cyprus - until 2012 when the standard rate of 17 per cent was adopted, and in the United Kingdom, where the standard VAT rate of 15 per cent was applied only in 2009. Apart from these states, the lowest VAT rates in the European Union were applied in Spain and Germany (until 2007, when the standard rate was increased to 19 per cent). The United Kingdom lost its status as one of the countries with the lowest VAT rates in the EU, by increasing the standard VAT rate to 20 per cent in 2011, and as well as Spain – in January 2013 – by increasing the standard VAT rate to 21 percent (Table 1).

Table 1. The change of the standard VAT rate in European Union countries

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 January
Ireland	21	21	21	21	21	21,5	21	21	23	23
Austria	20	20	20	20	20	20	20	20	20	20
Belgium	21	21	21	21	21	21	21	21	21	21
Bulgaria	20	20	20	20	20	20	20	20	20	20
Czech	19	19	19	19	19	19	20	20	20	21
Denmark	25	25	25	25	25	25	25	25	25	25
Estonia	18	18	18	18	18	20	20	20	20	20
Greece	18	19	19	19	19	19	23	23	23	23
Spain	16	16	16	16	16	16	18	18	18	21
Italy	20	20	20	20	20	20	20	20	21	21

Great Britain	17,5	17,5	17,5	17,5	17,5	15	17,5	20	20	20
Cyprus	15	15	15	15	15	15	15	15	17	18
Latvia	18	18	18	18	18	21	21	22	22	21
Poland	22	22	22	22	22	22	22	23	23	23
Lithuania	18	18	18	18	18	19	21	21	21	21
Luxemburg	15	15	15	15	15	15	15	15	15	15
Malta	18	18	18	18	18	18	18	18	18	18
Netherlands	19	19	19	19	19	19	19	19	19	21
Portugal	19	21	21	21	20	20	21	23	23	23
France	19,6	19,6	19,6	19,6	19,6	19,6	19,6	19,6	19,6	19,6
Romania	19	19	19	19	19	19	24	24	24	24
Slovak	19	19	19	19	19	19	19	20	20	20
Slovenia	20	20	20	20	20	20	20	20	20	20
Finland	22	22	22	22	22	22	23	23	23	24
Sweden	25	25	25	25	25	25	25	25	25	25
Hungary	25	25	20	20	20	25	25	25	27	27
Germany	16	16	16	19	19	19	19	19	19	19
EU	19,4	19,6	19,4	19,5	19,4	19,8	20,4	20,7	21,0	21,2

Source: compiled from Taxation trends in the European Union, 2012, p. 28 and the VAT Rates in the Member States of the European Union, 2013, p. 3

Over a period of 2004 – January 2013, the unchanged rate remained in only nine member states of the European Union - Austria, Belgium, Bulgaria, Denmark, Luxembourg, Malta, France, Slovenia and Sweden. In other countries the rate varied from 1 to 4 times (Portugal). In Lithuania the standard rate of VAT changed twice from 2004: in 2009 it was increased from 18 per cent to 19 per cent and in 2010 it was increased to 21 per cent.

It should be noted that over the period of 2004 – 2008, the average EU standard VAT rate was almost stable (ranging from 0.2 percentage points), but in 2008 in the onset of the global economic and financial crisis, the standard VAT rate began to grow and from 2004 to January 2013 it increased by 1.8 percentage points (from 19.4 per cent to 21.2 per cent). The growth trend is visible until this year (Fig.1).

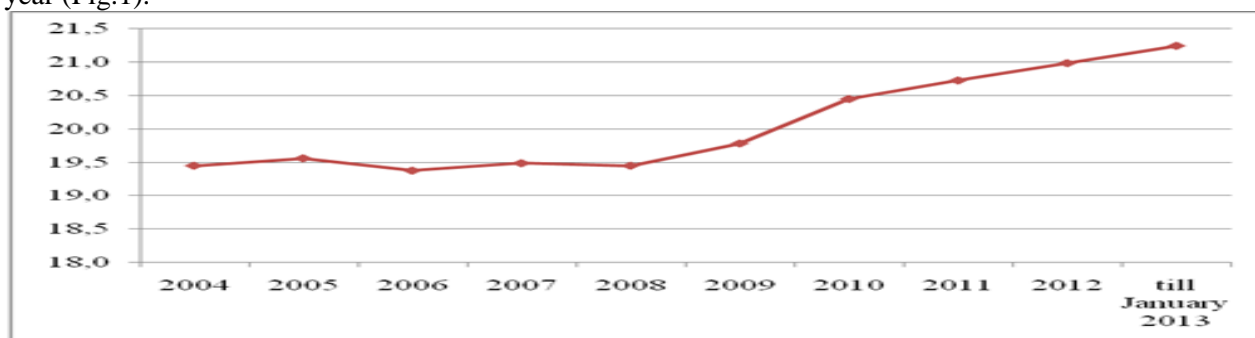


Figure 1. The change of the average EU standard VAT rate. Source: compiled from Taxation trends in the European Union, 2012, p. 28 ir VAT Rates in the Member States of the European Union, 2013, p. 3

Since 2009 the standard rate of VAT was changed immediately in many countries: in 2009 – in six member states, in 2010 - in nine states, in 2011 and 2012 – in four states, in January 2013 – in five states, while in the previous periods, the immediate change was introduced only in one (2006 - 2008) or two states (2005).

The maximum VAT rate changes during the examined period were observed in Hungary when in 2006 the standard VAT rate was reduced by 5 percentage points and in 2009 when the rate was restored increasing it by 5 percentage points. Also, VAT standard rate increased by 5 percentage points (from 19 per cent to 24 per cent) per year in Romania. Large changes of rates per year during

the given period were visible in Greece (in 2010 the rate increased from 19 per cent to 23 per cent) and in Latvia (in 2009 the rate increased from 18 per cent up to 21 per cent).

According to the Council's Directive 2006/112/EC of 28 November 2006, due to the common value added tax system, Member States may apply one or two reduced rates. The reduced rates are a percentage of the taxable value, which may not be less than 5 per cent, but exceptions are specified to some states that may apply a reduced rate of less than 5 percent. This right is exercised by Spain, setting a reduced VAT rate of 4 per cent, France - 2.1 per cent, Ireland - 4.8 per cent, Italy - 4 per cent and Luxemburg - 3 per cent. In general, under the Directive reduced rates can be applied only for the supply of goods or services attributed to defined categories. Member States may also apply the reduced rate of natural gas, electricity or district heating, if there is no threat of competition distortion. Every second year the Council reviews the area of applying reduced rates.

By providing tax relief an incentive is granted to use a specific product or service, thus tax revenue collection is increasing. Even though the reduced VAT rates over the short term may reduce the tax revenue collection, in the medium-term tax relief as the consumer incentive measure outweighs the revenue losses. Also, the reduced rates of VAT act as subsidies of a specific economic sector, thus they affect the profitability of that branch of industry and increased employment in that branch (Bikas, Saikevičius, 2010).

Under the Directive 2006/112/EC, the following activities may be VAT exempt, as regulated conditional activities related to the following areas: certain activities related to public interest; other activities exempt from VAT; intra-Community transactions - the supply of goods, acquisition of goods within intra-Community; certain transport services; import; export; related to international transport; certain transactions treated as exports; mediation services; exemption from VAT of international trade transactions - Customs warehouses, other (non-customs) warehouses and similar procedures, trade transactions for export purposes between Member States.

VAT may be not applied only for a few reasons: in order to protect certain economic activities, thus to create a favorable environment for them or due to VAT accounting (in some areas it is difficult to determine the added value, thus, taxation becomes complicated) (Bikas, Rashkauskas 2011).

The category of passengers and their baggage transportation as well as social goods and services category (across the 23 EU Member States), as well as food, access to cultural and recreational events, goods and services of hotel accommodation categories (across the 22 EU Member States) can be attributed to widely used categories under relief conditions specified by the EU. Meanwhile, the services benefits introduced for the cleaning of windows and premises in private homes are applied only in four countries (France, Ireland, Luxembourg, and Slovenia). Also, few countries make use of the right to apply special exemption from tax conditions for hair cut services category or a category of small repair services of bicycles, shoes and leather goods, clothing and household textile (in eight states).

Analysis of factors determinant accumulation vat

Legeida ir Sologoub (2003), simulating VAT distinguishes two main factors' groups, influencing VAT accumulation: VAT rules (rates, basis, etc.) and other variables of economic activities, conditioning tax basis and compliance of tax regulations. Others state that influence for level of VAT income and coefficient c-effectiveness has standard rate, honesty (characterized as average level of import and export in gross domestic product), period from VAT institution, accumulation of knowledge, related to tax administration, and margin between the highest and the lowest, except zero, rates.

Hence, VAT income is determined by a number of factors, including economic situation of the country, which is best characterised by gross domestic product. In addition, the higher the standard of life in the country, considered as GDP per capita, the higher the consumption, the better awareness of tax payments and lower tax fraud, consequently the relationship with GDP per capita is extra revised. Due to the fact, that VAT is consumption tax, primarily VAT income depends on the consumption level in the country. To identify what influences more TAV income – governments or households' consumption, the relationship not only with the general consumption, but also with both variables, is examined. On the one part, TAV income, in addition to the mentioned above factors, is determined by the level of export and import. Export rate is zero, so the grow of expert could have a negative impact on VAT.

On the other part export growth mostly follows domestic production, which could be pronominal as a result of households' disposable income or demand increase. Variation in import VAT has an opposite influence for income. The higher the import the lower is demand of domestic goods. As import is the target of VAT in the consuming country, the import increase results higher VAT income (Hybka, 2009). Bikas and Rashkauskas (2011) sized up households as the main VAT payers, and, as their core income is wage, authors subsume unemployment as a factor influencing increase of VAT income.

To estimate whether mentioned factors influence VAT tollage in European Union following (1) formula correlation coefficients is calculated (Kėdaitis, 2009, p. 91):

$$r = \frac{\sum (x - \bar{x})(y - \bar{y})}{\sqrt{\sum (x - \bar{x})^2 \times \sum (y - \bar{y})^2}}; \quad (1)$$

Here: x and y – stochastic value;

\bar{x} and \bar{y} – sample means

Multipartite regression model is composed to estimate the influence of established significant factors for VAT tollage into country's budget. This model in addition allows forecasting accumulation of such income. Expression of multipartite linear regression equation is presented in (2) formula (Bilevičienė, Jonušauskas, 2011, p. 199):

$$y = \beta + \beta_1 x_1 + \beta_2 x_2 + \beta_3 x_3 + \dots + \beta_k x_k + \varepsilon; \quad (2)$$

Here: β – coefficients (constant);

x – independent variables;

ε – stochastic error.

Calculations are made using 2004 – 2011 data of European Union members, presented by Eurostat – since Lithuania joins EU till last data presented. Correlation coefficient between VAT income tollage and factors influencing it were calculated and resented in the table in order to estimate causes conditioning VAT accumulation in European Union countries (table 2).

VAT tollage is determined by economic factors as well as by resolutions of governments of the countries. So, the interrelationship was examined between factors, reflecting macroeconomic ratios, and VAT regulations, established by governments. The latter covers relationship between VAT income tollage and standard VAT ratio. In addition, to estimate influence of exemption, margin between the highest and the lowest, excluding zero, VAT ratios are used. It is proposed that the longer the period of VAT institution in the country, the more effective is its administration, more evident and comprehensible taxable, and for society – payment, regulations, grater acceptance of society paying it, accumulated more knowledge and practice related to tax administration, so the relationship with the period of VAT institution is examined. Hence, theoretical positive relationship between standard VAT ratio, period of VAT institution and tollage of income exists (increasing of mentioned variables tollage of VAT income increases). Negative relationship should exist (when one increase, another decreases) between margin of highest and lowest, except zero, VAT ratios and tollage of VAT income. Notwithstanding directives of EU established general VAT system, however countries have a lot of freedom instituting their own VAT systems in implementation stage, therefore it is complicated to ascertain general quantitative ratios related with VAT regulations set by a country. Due to this, characterizing European Union as a general territorial unit, all chosen ratios, describing governments' decisions, are used as an arithmetical mean of all EU 27 until 2007 including Romania and Bulgaria.

The interrelationship between VAT income and these chosen macroeconomic ratios, characterizing economic situation: gross domestic product, gross domestic product per capita, consumption costs, households' consumption costs, governments' consumption costs, export, import and unemployment in the country is analysed. Increase of gross domestic product, gross domestic product per capita, consumption costs, households' consumption costs, governments' consumption costs, import raise VAT income (positive relationship exists), while increase of export and unemployment influences VAT income drop (negative relationship).

Table 2. Correlation coefficient of VAT and factors influencing it in EU

	GDP	GDP per capita	Consumption costs	Households' consumption costs	Governments' consumption costs	Export	Import	Unemployment.	Standard VAT ratio	Margin between VAT ratios	Period of VAT institution
Ireland	0,88	0,99	0,51	0,65	0,25	-0,26	0,24	-0,81	-0,33	-0,41	-0,52
Austria	0,97	0,96	0,99	0,98	0,99	0,76	0,78	-0,67	-	-	0,99
Belgium	0,99	0,99	0,96	0,98	0,94	0,93	0,92	-0,64	-	-	0,96
Bulgaria	0,90	0,87	0,95	0,95	0,92	0,84	0,94	-0,65	-	0,05	0,77
Czech	0,98	0,97	0,99	0,99	0,99	0,93	0,91	0,04	0,65	-0,94	0,96
Denmark	0,95	0,97	0,88	0,94	0,76	0,94	0,94	0,06	-	-	0,81
Estonia	0,96	0,96	0,94	0,94	0,81	0,78	0,77	-0,03	0,36	-0,36	0,74
Greece	0,88	0,87	0,81	0,84	0,62	0,88	0,88	-0,14	0,35	0,37	0,61
Spain	0,03	0,15	-0,04	0,09	-0,24	0,28	0,58	-0,41	0,14	0,14	-0,15
Italy	0,87	0,86	0,82	0,85	0,69	0,88	0,94	-0,09	-	-	0,75
Great Britain	0,84	0,81	0,85	0,86	0,69	0,68	0,79	-0,44	0,75	0,75	-0,27
Cyprus	0,85	0,96	0,86	0,90	0,68	0,91	0,97	-0,08	-	-	0,68
Latvia	0,85	0,82	0,84	0,87	0,72	0,66	0,95	-0,38	-0,06	0,04	0,40
Poland	0,98	0,99	0,98	0,98	0,97	0,97	0,99	-0,88	0,46	-0,46	0,86
Lithuania	0,99	0,99	0,96	0,97	0,91	0,88	0,95	-0,02	0,40	0,40	0,78
Luxemburg	0,95	0,89	0,99	0,98	0,98	0,90	0,89	0,09	-	-	0,99
Malta	0,97	0,97	0,96	0,97	0,94	0,93	0,92	-0,55	-	-	0,97
Netherlands	0,95	0,96	0,90	0,95	0,83	0,89	0,90	-0,76	-	-	0,80
Portugal	0,63	0,66	0,58	0,69	0,18	0,81	0,89	0,24	0,63	0,65	0,42
France	0,96	0,98	0,89	0,92	0,82	0,91	0,97	-0,25	0,00	-	0,83
Romania	0,95	0,96	0,95	0,97	0,85	0,92	0,99	-0,64	0,48	0,45	0,79
Slovak	0,98	0,98	0,97	0,98	0,95	0,96	0,96	-0,70	0,52	0,09	0,95
Slovenia	1,00	1,00	0,94	0,95	0,89	0,92	0,88	-0,08	-	-	0,88
Finland	0,96	0,94	0,95	0,97	0,91	0,64	0,88	-0,49	0,64	-	0,92
Sweden	0,96	0,92	0,99	0,98	0,99	0,90	0,93	0,14	-	-	0,89
Hungary	0,74	0,76	0,65	0,68	0,52	0,78	0,70	0,71	0,23	0,23	0,81
Germany	0,94	0,95	0,95	0,94	0,93	0,85	0,86	-0,98	0,95	0,95	0,97
EU	0,97	0,97	0,94	0,97	0,82	0,99	0,99	-0,20	0,58	0,20	0,79

Source: authors' calculations based on Eurostat data

Calculated correlation coefficient educed all relationships between VAT income and chosen ratios in European Union states, except export and margin between highest and lowest, except zero, VAT ratios, purposed: between gross domestic product, gross domestic product per capita, consumption costs, households' consumption costs, governments' consumption costs, import, VAT ratio, period of VAT institution and tollage of VAT positive relationship exists, while between unemployment and VAT income – negative. The increase of export negatively influences VAT income due to zero ratios, but export growth commonly follows domestic production. Due to this it could be stated that households' disposable income or domestic consumption increases together, thus

export could positively influence VAT income. Only in Ireland correlation coefficient between export and VAT income gets negative value.

The strongest relationship in EU (meaning of correlation coefficient 0.99) exists with ratios characterizing international trade, i.e. import and export. Also very strong relationship exists between gross domestic product, gross domestic product per capita, households' consumption costs, and general consumption costs (meaning of correlation coefficient between 0.94 and 0.97). Medium depth relationship exists between VAT tollage and government consumption costs (0.82), period of VAT institution (0.79), standard VAT ratio (0.58). While calculated correlation coefficient with margin between highest and lowest (except zero) VAT ratios shows that mentioned ratio influences slightly VAT income in countries' budgets (correlation coefficient meaning amounts 0.20). Relationship between unemployment rate and VAT income is adverse, i.e. the higher is the level of unemployment in European Union the lower is the amount accumulated by VAT income, but this relationship is not strong (correlation coefficient meaning amounts -0.20).

The strongest relationship with chosen ratios in European Union was found in Check, Germany, Belgium, Malta and Slovakia, while the weakest relationship according calculate correlation coefficient has Spain, Ireland and Latvia. Notwithstanding analyzing EU as a integrated territorial unit the strongest correlation relationship with VAT tollage was stated for export and import, however analyzing all EU members it is seen, that majority of countries had a very strong relationship (exceeding average 0.90 meaning of correlation coefficient) with households' consumption costs (19 countries), GDP (18 countries) and GDP per capita (18 countries). At that point very strong correlation coefficient with VAT tollage has export and import respectively 12 and 15 countries. Comparing with other factors the weakest correlation with VAT tollage is coherent with unemployment rate, margin between highest and lowest VAT ratios and standard VAT ratio (the meaning of correlation coefficient is lower than 0.50) in EU as integrated territorial unit and in majority of separate countries (accordingly 16, 11 and 10 countries).

To estimate the reliability of correlation coefficients t statistics is computed and compared with Stjudent distribution. The results obtain comparing t statistics with Stjudent distribution (2.45) show that calculated correlation coefficient between VAT tollage and standard VAT ratio in EU as integrated territorial unit and all EU member states, except Germany, do not show reliable relationship. Either reliable relationship does not show correlation coefficient calculated between VAT tollage and margin between highest and lowest, except zero, ratios in EU as integrated territorial unit and in majority countries (except Germany, Check and United Kingdom). It is impossible to rely on relationship calculated between VAT tollage and unemployment rate (reliable relationship exists only in Ireland, Poland, Netherland and Hungary) either. Thus, these ratios will be not included estimating factors, influencing VAT tollage in EU. Considering that the period of VAT institution and unemployment rate comparing with other ratios has lower correlation coefficient and unreliable relationship recorded in conditionally more countries (accordingly 7 and 9 countries), these ratios will also be not included into regression model to reveal complex influence on VAT tollage.

It is not possible still and all to state that unemployment rate in the country and other ratios have no impact on VAT tollage. Unemployment rate in the country indirectly influences the VAT tollage into the budget via level of income and consumption. Also standard ratio and margin between highest and lowest VAT ratios are efficient means of governments to balance budget income in the period of economic fluctuations, though are not included in the regression analysis as influencing factors. Naturally one common ratio in all European Union member states will not ensure the same income from VAT due to different development level, administration, that is difficult to estimate quantitatively, progressiveness, varied mentality of countries' citizens, influencing level of shadow economy and other factors, however it also negatively effects VAT tollage in countries.

Thus, the following model determining VAT income factors is constructed via strongest, reliable and linear relationship causes: GDP, consumption costs, households' consumption costs, export, import and GDP per capita:

$$y = -907222,59 - 0,42x_1 - 0,06x_2 + 0,50x_3 + 0,28x_4 - 0,26x_5 + 158,80x_6$$

Here: y – VAT tollage;

x_1 – gross domestic product;

x_2 – consumption costs;

- x_3 – households' consumption costs;
- x_4 – export;
- x_5 – income;
- x_6 – gross domestic product per capita.

Testing how constructed model corresponds the real tollage VAT income the results are presented in figure 2.



Figure 2. Calculated and concrete tollage VAT income in EU in 2004-2011, million Euros. **Source:** authors' calculations according Eurostat data.

The investigation shows that constructed model with chosen variables properly exactly determines tollage VAT income. Calculated and concrete tollage VAT income in analyzing period (2004-2011) differs less than 0.5 percent. Thus it could be stated that constructed model is suitable to forecast VAT income and designate main ratios, influencing VAT tollage: GDP, consumption costs, households' consumption costs, export, import and GDP per capita.

Conclusion

VAT – is indirect tax, assessing public and private consumption. The entire burden is shifted on consumers as tollage is collected via price system. According to VAT structure value added is created in each stage of production process, thus each stage carries out income into governments' budget.

VAT was regulated for the first time in 1970 by the first and second directives in European Economic Community. The foundation for VAT harmonization was made by sixth directive in 1977, which regulates practically all sides of VAT application.

EU countries apply standard VAT ratios, which are established by each country as a percentage of taxable value, but it could not be less than 15 percent. VAT ratio in EU countries varies in 12 percentage points (from 15 percent to 27 percent). EU member states could apply one or two exempt ratios. Established exempt ratios are percentage part of taxable value, not less than 5 percent, but according provided exemptions some countries apply even lower.

To designate factors, influencing VAT income, correlation coefficient between established VAT regulations (standard VAT ratio, margin between highest and lowest, except zero, VAT ratios and period of VAT institution), ratios, characterizing economic conditions (GDP, GDP per capita, consumption, household' consumption, governments' consumption, import, export and unemployment rate), that positively influence VAT income, was calculated. The obtained results show that reliable and strongest relations exist between ratios, characterizing economic conditions (GDP, GDP per capita, consumption, household' consumption, import and export), that positively influence VAT income. VAT income tollage is more influenced by households' consumption than governments'.

Though it is impossible to conclude that the relationship does not exists with decisions made by government in the field of VAT or unemployment rate as they can indirectly influence VAT income. However VAT income model, which exactly enough characterizes VAT income (deviations between calculated and concrete tollage VAT income is below 0.5 per year) relies only on factors containing the strongest and reliable meaning.

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COMPETITIVE ANALYSES OF LOCAL BAKERIES IN PRISHTINA/ REPUBLIC OF KOSOVO

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Abstract:

The main problem of today's companies is the division between marketing and sales as separate departments in company, or better saying, including the sales as division within the marketing department. Through this "regulation" of departments, enterprises will have more knowledge about market and competition and will be a step forward their competitors. The main purpose of this paper is to identify competitive analyses of local bakeries in the Capital City of Kosovo, Prishtina, and define how they act toward the competition and what strategies they use to compete in a very competitive business environment, pricing or quality based products offered to customers.

While doing a research and analyzing competition and competitive strategies of bakeries, I found out that most of bakeries are based on achieving their competitive advantage in the market through lower prices than competitor and few of them based its strategy toward offering qualitative products and services to the customers and through it they have a better image and got customer loyalty. This situation is as a result of not having marketing department in any bakery or a person who is responsible for marketing. The only reason for not having established marketing was that these companies need more time to transition from sales to marketing activities.

The data for research were collected through questionnaire in fifteen bakeries within the Prishtina city. Methods used for research have been descriptive, comparative, analysis, and synthesis. The research instrument was a questionnaire, the technique has been direct communication and research was conducted between months February and March 2012.

Key Words: Competition, advantage, strategy, bakery, quality

Introduction

Bakery assortment of products in Prishtina is based mainly on production of different types of bread on sizes from 300 gr. up to 800 gr., but the most popular one is the bread of 500 gr., and also in assortment are included raw croissants, bread for hamburger (small pieces of bread), and bread for sandwiches. These are typical products and in a way traditional products of bakeries for years. Bakeries that have mixed their offer with patisserie products are not included in this paper. However, their competitive analyses are still poor and they are focused on their strategy mainly by following the market leaders through pricing strategy. They think only how to attract new customers and retain existing ones. But they should consider not only needs of the market, but also competitor strategies. *The first step is competitor analysis, the process of identifying, assessing, and selecting key competitors. The second step is developing marketing strategies that strongly position the company against competitor and give it the greatest possible competitive advantage*²⁶. Based in a first step remarks above, every industry should keep in mind and be careful on forces that determine competition. *The state of competition in an industry depends on five basic competitive forces: rivalry*

²⁶ Kotler, Ph. and Armstrong G. *Principles of marketing*, Ninth Edition, Prentice Hall International, Inc, New Jersey, USA, 2001, page 682

among existing firms, bargaining power of buyers, threat of new entries, bargaining power of suppliers and threat of substitute products or services.²⁷ Bakeries in Prishtina haven't done any competitive analyses, excluding the case they analyze potential threat from new entries and during the period there is a lack of flour in the market, they discuss how to reduce bargaining power of suppliers. Customer care for them means offering quality fresh bread and "appropriate" prices for bread, but line extension is still only as solution for future, because they still think they will get new customers and retain existing ones through quality and competitive prices. Building a sustainable growth strategies and profitable growth through differentiation or cutting cost of production and through extension of production assortment is still not in their planes.

Marketing definition

Marketing is the main function within the organization since it connects enterprise/products or services with customers. Every day in every step we do have marketing, we do promote ourselves or our products, we offer the value to the market and benefits they have from our products or services and we expect in return to have success in the market, to have profit and through that profit to grow company by adding new products, new lines of production, new brand and finally new extension on the market, we increase our market share. Therefore, Marketing is defined by different authors and associations in different ways, but each and every author gives the point on his/her definitions on customers and value to the customers. They keep in mind also competition and the role of competition for our company as inspiring to improve our products and services better than competition do. That means, to give customers a strong reason why to buy from us and not from competitors. The most famous author of marketing, Philip Kotler says: "Marketing is social and managerial process whereby individuals and groups obtain what they need and want through creating and exchanging products and value with others"²⁸. Other definitions about marketing, worth to mention are: "Marketing is a process of planning and implementing concepts of pricing, promotion and distribution of ideas, goods and services with the aim to create the exchange which fulfills the needs of individuals and organization"²⁹. To compete with others means having in mind to mix well for elements of marketing mix, product, price, place and promotion and make everything work in a strong circle and interaction between them.

Competitive analyses

Competitive analyses should progress through the following stages:

- Identification- Identify all current and potential brand, product, generic, and total budget competitors
- Characteristics- Focus on key competitors by assessing the size, growth, profitability, objectives, strategies and target markets of each one
- Assessment- Assess each key competitor's strengths and weaknesses, including the major capabilities and vulnerabilities that each possesses within its functional areas (marketing, research and development, production, human resources, and so on).
- Capabilities- focus the analysis on each key competitor's marketing capabilities in terms of its products, distribution, promotion and pricing.
- Response- estimate each competitor's most likely strategies and responses under different environmental situations as well as its reaction to the firm's own marketing efforts.³⁰

Based on these stages, every company should pay attention to their competitive environment and take all necessary steps toward the creation of comparative advantages in the market and give strong reasons to their customers why should they buy from them and not from their competitors.

Knowing the competition, based on above mentioned stages, means that we are ahead them, but we should know what kind of strategies of marketing to use and overcome competitors. Michael

²⁷ Porter Michael, Competitive strategy, Techniques for analyzing industries and competitors, The free Press, new York, USA, 1980, page 3-4

²⁸ Kotler, Ph & Keller K. *Marketing Management*, 14th E., Prentice Hall, New Jersey, USA, 2012, page.5

²⁹ American Marketing Association, *Marketing News*, March 1, 1985

³⁰ Ferrell, O.C. and Hartline D. M. " *Marketing Strategy*" 4th Edition, Thomson South Western, Mason, USA, page 101

Porter³¹ was the first author defining so called three generic marketing strategies. These strategies will help company to face easier competitive forces in the market, and they are:

- Low cost strategy
- Differentiation strategy
- Focus strategy

Methodology

The object of the research was to identify and assess competitive analysis of 20 bakeries within Prishtina City, that produce different types of bread, bread loafs, „bread for humbergurs“, „bread for sandwiches“, croissants, etc. Initially a questionnaire based survey, was prepared and the results of which are part of this paper.

Main methods which are used in this paper are: descriptive method, comparison method, analyses method, synthesis method.

Survey questionnaire was used as the main research instrument, consisted on 7 questions to 20 bakeries, while direct contact with company management was made at the beginning of the research. The survey was conducted between February and March 2012.

Results

While doing research and discussing questions of questionnaire, I have noticed that most of interviewers to whom I made question about the competition, was afraid in a way to answer thinking that I am part of any competitor which made me think that they are aware of huge current competition and future one.

First question was about identifying do they make competitive analyses in the market, on their own or they do engage an agency to do for them and do they actually make analyses. Responds have been very strange because only 5 companies did competition analysis; none of them has engaged external agencies and 15 of them declared they never did analysis of competition. This is shown in the Table 1 below.

Table1. *How do you do competition analysis?*

a) By yourself	5
b) By external	0
c) Never do	15
Total	20

Next question was about how they compete with competitors and questions also have been very different. Most of them, fifteen companies declared that they “fight” with competitors through prices, three of them declared they base their strategy to compete through quality of products and by keeping the weight of products as we declare, and two of them declared they base their strategy on offering better assortment to customers, through variety of goods and do have better service than competitors. This is shown in the table 2, below.

Table2. *How do you compete with your competitors?*

a) Through price	15
b) Through quality	3
c) Better assortment	2
Total	20

Since we had the most answers on price as a “solution” for competing with competition, next question was based on asking them what prices they think are most suitable to compete, and based on answers, as shown in Table3 below, two of them declared that they would compete by much lower prices than competitors, eight of them declared that they try to be lower in pricing than competitors, seven of them declared they compete same as competitors do and only three of them declared that they based pricing strategy on cost plus profit method of compiling their price.

³¹ Renko, Natasa. “*Strategije Marketinga*” Naklada Ljevak, Zagreb, Croatia, 2005, page 188, quotation of Porter, E.M. *Competitive Strategy*, The Free Press, New York USA, 1980, page 34-46

Table3. *What is your pricing strategy?*

a) Much lower than competition	2
b) Lower than competition	8
c) Same as competition	7
d) Cost plus profit strategy	3
Total	

Staying on the same issue, pricing, next question was about the situation when they would lower the price, but knowing that competitor would do the same. Answers, as shown in table 4, have been different. Ten of them would lower the prices even they know competition will follow them, seven of them would not lower the price if they know competition will do the same, and three of them declared they would not do it if there is an solution to avoid, in case of no other solution, they would do that also.

Table4. *Would you recommend lowering the price if competitors will follow you?*

a) Yes	10
b) No	7
c) Yes, if there is no other solution	3
Total	20

Pricing strategy and “fighting” through prices with competition was the next question and my idea to ask from them the opinion is it possible to make an agreement with competitors to avoid this fight. Results are show in Table 5 below and stands as follows: fifteen companies declared that they believe in an agreement with competitors with the aim to lower their prices and fight with them through prices because that would damage end users; five of them would not do any agreement with competitors believing that they do not care what competitors will do until they keep good quality of products and based on their answers, they do care only what consumers of products say and if consumers like and buy their products, they will continue with this conditions of production.

Table5. *Do you believe in an agreement with competition to avoid “fighting with prices”?*

a) Yes	15
b) No	5
Total	20

In previous answers from interviewed companies, the most of them declared they would like to compete through low cost strategy. Identifying which of generic strategies they would use to compete with competitors, not leaving only with low cost strategy, I compiled the question consisting of three generic strategies of Porter, to identify what they think is the best strategy to compete and gain comparative advantage and the results are shown in Table 6, below: eleven companies declared they would gain advantage through low cost strategy, five of them through differentiation and four of them through focus on specific market, specific product or specific geographic area.

Table6. *Which is better strategy to compete and gain comparative advantage in the market?*

a) Low cost	11
b) Differentiation	5
c) Focus	4
Total	20

Last question, compiled to get the answer from them on how they think they will implement low cost strategy, was based on possible ways and channels how to lower their cost. As shown on Table 7. Thirteen companies have answered through lower energy cost, meaning to switch production from electric energy to another source of energy (wood energy or gas), six of them would do that through cutting distribution cost by installing a device that will not let drivers to make extra expenditures while transporting their goods, and only one company declared they would cut promotional cost for a bit since they are well positioned in the market and don't need to spend too much on promotion.

Table 7. How would you implement low cost strategy?

a) Lower energy cost	13
b) Cut distribution	6
c) Cut promotional	1
Total	20

Discussion

During my research and based on questions I got from the questioner, it is obvious that analyzing competition is a very difficult and tough job and needs skills and market research continuously, to see how competitors are dealing with production, their markets, customers, etc. Company should know in advance what competitors are doing, and only then, should know how to act toward these forces coming from competitors and from business environment. *“Knowledge of the company’s capabilities and the causes of the competitive forces will highlight the areas where the company should confront competition and where avoid it. If the company is low cost producer, it may choose to confront powerful buyers while it takes care to sell them only products nor vulnerable to competition from substitutes”*³². Based on above said by Porter, company should know the causes of the competitive forces and only then, highlight how and where to confront competitor. Bakeries in Kosovo, as was shown on results from questionnaire, are making very low efforts to analyze the competition. 75% of them has never did any analyze of competitors; they are based mostly to run the fighting through prices, to lower their prices and get comparative advantage through that method. The end user, consumer, will not benefit from that. Kosovo has very good sources for producing flour, and avoid imports of flour, so this is as a good chance to do that and gain then, through vertical integration strategy, comparative advantage among competition in the market. These would reduce their cost up to 20% which is quite a good difference when formulating the selling price. I see also as an issue not engaging several existing good agencies from Kosovo or from the region to do market research and to have a view of their positioning into the market toward their competitors. It is not enough to get satisfaction only on current situation, without having in mind the increased level of prospect/ future competitors in an industry that entry barriers are low or have not barriers. Today’s common goods market is very popular and Kosovo is facing entrance of international companies every day, especially in the food industry. This should be as an extra reason why bakeries should compile market research and avoid failures in business as it is happening every day, not only in heavy industry, but also in such business as bakeries are.

Conclusion

Based on the research and on the answers I got from twenty respondents, mainly managers of bakeries, I could conclude as follows:

- Bakeries in Prishtina City, are still lacking to do proper market research, especially to search on competitors and most of them do not analyze competitors;
- Most of them compete with competitors through pricing strategy, lowering their prices;
- Low price strategies they base more on following actions of competitors than quality of their products;
- Low cost strategy could be implemented through cutting electric energy cost, and switching system to another source of energy, wood energy or gas energy which is cheaper;
- Even the fact that is hard to differentiate their products, they could do differentiation of their products through size, packaging, and brand extension so that customer will position their products and identify easy;
- Focus strategy also could be done if they concentrate their efforts toward niche markets and gain comparative advantage in the market;
- They would agree with competitors regarding pricing, but this would not benefit customers who are ready to pay for value of products and not only for price;

³² Michael E. Porter, *How competitive forces shape strategy*, Harvard Business Review, March - April 1979, page 8

- Bakeries should pay attention to avoid “fight” with prices and instead that, search after vertical integration strategies, buy or rent a mill and cut costs very easily;
- Having in mind that they are dealing in a very competitive business environment, bakeries should try to extend their production and give more choices to customers; this would make them innovative toward customers and keep existing customers and gain new customers.

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A DOCTRINAL PROMENADE INTO THE HEART OF THE BUSINESS CYCLE THEORY: BRIEF AUSTRIAN HALT

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Abstract:

Throughout this paper we propose a brief doctrinaire promenade starting with the Monetarist approach, reaching the Keynesian doctrine and finishing with the point of maximum interest, namely the Austrian perspective regarding imbalances. Exhaustively passing through the theories mentioned above, along with their fundamental perspective regarding the phenomenon of economic cycles, does not represent the basis for the current paper. The specialized literature has no shortage of such work. The purpose of this research is to highlight the explanatory strength of the Austrian business cycle theory, establishing the reasons for considering it the best cemented one in regard to the recurrence of crises. For being able to arrive to such a judgment, we employed a contradictory approach between the Austrian doctrine and the Keynesist, respectively, the Monetarist one. The conclusions we reached reflect a healthy Austrian vision in regard to addressing the issue of economic crises. Therefore, complying the basic Austrian principles can ensure prosperity to the economies that decide to apply them.

Key Words: Crisis, Business cycle, Austrian School, Keynesian, Monetarist

Introduction

Approaching the theory of economic cycle is not an issue that comes in hand. We are permitted to make such a statement based on the idea that explanations concerning the business cycle theory are strictly related to how each school of thought was able to understand the system that determines the market, with its habitual basic functions, to operate; how was the idea of long-lasting prosperity understood and, last but not least, which is the role of the state in this entire bewilderment.

Although some of the dominant doctrines tend to insist on rather a few particular factors, considered to be the most important ones in regard with the responsibility for triggering crises, in fact the problem can be viewed from various angles. Based on this statement, nowadays the perspectives from which the business cycles can be disentangled requires the participation of a consistent number of elements that, according to different economic schools of thought, bare the guilt for economic disequilibrium; thus, the problem is either *monetary expansion*, *state interventionism*, *excessive regulation*, *lack of regulation*, *low level of consumption*, *various changes in consumer preferences* and so on. Trying to discern which factors bring more enlightening answers regarding one of the biggest dilemmas that economy has had to face during the years, namely the recurrence of recessions, our attention was captured especially by the explanations coming from the Austrian School.

This paper is structured as follows: for the **first part** we choose to define the general framework of the present research by making concise referring to the problematic taken under consideration. The **second section** offers a brief overview of the business cycle theory starting with the monetarist perspective and passing through the Keynesian one in order to arrive, in the **third section**, to the point of main interest, namely the Austrian view. Emphasis is placed on some of the key aspects of the business cycle, more precisely, the channels through which the monetary injections are made and the manner in which they affect the production structure; the interest rate and the price level are also taken into consideration. The paper ends with final remarks.

The doctrinal inventory of the business cycle theory

The classical foundations of the business cycle theory can be identified, in a cohesive form, since 1860 in the works belonging to the French economist Clement Juglar. Based on statistical calculations, carried out in his research *Commercial crises and their periodical return to France, England and the United States (1862)*, Juglar was able to identify, as the main cause of economic fluctuations, the policies undertaken by banks.

Regarding another classical approach, we are particularly referring to the one formulated by Karl Marx. The author of the well-known book *The Capital* (1887) believes that the prejudices caused by the cyclicity of crises are rooted in the development of the capitalist system. Marx's view concerns the fact that periodic fluctuations are an integral part of the capitalist process. In this regard, he came to be known as the economist who assumes that business cycles have a due date once around 10 years; or, in other words, business cycles are decenal. His demonstration is based on the idea that the source of economic crises is none other than the constant tendency for renewal of fixed capital. A good use of capital, as well as the state of competition on the market, forces entrepreneurs to invest their profits and to continually seek innovative ways in which they can increase productivity. One of the best options comes, in this direction, from the increased mechanization of production which will lead, according to Marx, to the establishment of massive unemployment. Eventually, the strongly capitalized economy will get acquainted with the crisis.

J.A. Schumpeter transformed Marx's conception regarding the renewal of capital into the concept of "*creative destruction*" (Schumpeter, 1943). The significance of this precise process, a conceptual bridge between the two economists mentioned above, can be translated through the constant necessity to find new methods of production, new forms of organizing the productive process in such a way as to obtain the maximum utility out of the existing possibilities. For both, Schumpeter and Marx, this capitalist accumulation process can be viewed as recurrent periods of routinization that break off when radical innovations come along and shake up the economy. The "creative destruction" destroys the old era and brings a new one into play. The economy experiences a boom until new opportunities for investment are inevitably exhausted, generating a crisis and depression. Thus, according to Schumpeter, although capital accumulation is a significant factor, it is after all innovation which is the fundamental cause of business cycles, as they have the power to change the entire economy.

However, the most revolutionary perspective on the business cycle was formulated around the triggering of the strongest crises of the twentieth century, namely, the Great Depression; we are particularly referring to the Keynesian doctrine. Taking into account the perspective of John Maynard Keynes regarding the cyclicity of business crises, formulated in his primary book *The General Theory of Employment, Interest and Money* (1936), we unravel the fact that he thus succeeded reshaping economics on a series of new basic principles which could be, in a very general manner, translated into state interventionism. According to Keynes, "... *If the government refrains from regulation and allows things to follow their natural course, the essential commodities will soon reach a price level accessible only for the rich, the worthlessness of money becomes apparent, and fraud on the public can no longer be hidden*" (Keynes, 1920, p. 240). Hence, by embracing the macroeconomic perspective, the British economist is not able to compass all the changes that take place inside the economic apparatus. This determines him to infer that markets are unable to automatically provide full employment of labor force thus, in times of crisis there may be encountered long periods of massive unemployment if market is left to solve the problem. The state is invited to intervene and help resolve the imbalances, having recognized as necessary the task of boosting the economy. In the first instance, the need to boost aggregate demand for goods and services is referred to. Thus, for Keynes and his followers, contrary to the Monetarist but especially to the Austrian view, waiting for things to settle by themselves is costly and redundant.

Keynes never saw too much investment in the economy; on the contrary, he thought there was too little. According to him, the purpose of the investment involves the production of goods and services that will increase the general level of consumption. This will subsequently lead to an augmentation in the volume of money spent by population, thus to social welfare: "... *the essential characteristics of the business cycle and especially its regular succession of movements as well as its duration, entitles us to speak of a cycle that is due, above all, to the way in which the marginal efficiency of capital fluctuates. The fairest thing that we can do is to look at the economic cycle as a*

phenomenon caused by a cyclical change in the marginal efficiency of capital, though complicated and often aggravated by associated changes of other important variables, on short-term belonging to the economic system" (Keynes, 2009, p.329). Therefore, regarding things from a Keynesian perspective, the problem must be sought inside the apparent collapse of investment spending. According to the ideas promoted in his *General Theory*, investment indeed depends on the volume of savings.

However, what imports is the way in which savings are determined. From his point of view, a very significant part is played by what Keynes refers to as "*forced savings*" (Keynes, 2009, p.141). This type of savings represent "...*the surplus of actual savings beyond what could be saved in the long run equilibrium, under conditions of full employment of labor*" (Keynes, 2009, p.142). It is this particular kind of savings that, in his acceptance, bare the guilt for the lack of sufficient funds needed for investment, later on, for unemployment and, eventually, for recessions.

The determination of savings also depends, in the Keynesian vision, on the business prospects and on creditors preference for liquidity; this latter aspect represents the one that establishes the market level of interest rate. Therefore, for Keynes there cannot be expressed any guarantee of the fact that an enhanced propensity to save, which occurs only when an augmentation in the social income is sensed, will cause an increase in the volume of investment. What Keynes wants to emphasize is precisely that the economic future abounds in uncertainties which determine entrepreneurs to act, mainly on the basis of animal spirits rather than on rational calculations. *General Theory* is hence trying to highlight that expectations are inconsistent, therefore investments, under the form of aggregate spending and employment, will be characterized, on a permanent basis, by volatility. This aspect, strictly linked to an unregulated capitalist system, will inevitably lead to the onset of strong economic fluctuations that will require government remedies to counteract the apparent weaknesses inside the market. And these proposed panaceas consist of measures to enhance aggregate spending.

Largely due to the support given to state involvement in the economy, the criticism oriented towards Keynesianism is mostly coming from the liberalist part. For Hayek, Keynes theory marks the way at which end lies a high level of government intervention that obstructs the proper functioning of the free market. According to the statements made by Milton Friedman, the Keynesian view of the business cycle "... *behind the vague math charts is simple and rather naïve*" (Friedman, 1998, p 126).

The Monetarist doctrine, initiated by Friedman, strongly advocates for a substantial reduction of the state role inside the economic mechanism. From this point of view their doctrine resembles the one belonging to the Vienna School. This is, in fact, one of the very few binders **linking these two schools of economic thought**; things change when arguments and proposals concerning the recurrence of crises are brought into discussion. If the Monetarist current finds the augmentation of the monetary base as the main solution to overcome imbalances, denying the inflationist phenomenon that inevitably arise from that expansionist action, the Austrian School declares itself vehemently against any version of monetary expansion; and this is because, in the Austrian sense, any attempt to expand the money in circulation considerably reduces the value of money and thus causes inflation.

A common issue for both the representatives of the Monetarist and the Keynesian tenets is related to price stability. For the representatives of both doctrines it is indicated that prices be stabilized, although, as we already know, market prices are determined on the basis of the free confrontation between supply and demand. It is all resumed to consumer preferences; therefore, volatility proves to be, in fact, the basic feature. Prices are sensitive to any change that comes from the part of demand, when consumer preferences change, or supply, when it is registered a decrease in production due to various interfering factors. Therefore, any recorded evidence of price level stability betrays state intervention. This deduction determines the adherence of Austrian representatives, the advocates of a healthy market economy, functional only under free competition and private property.

Thus, discussing about the perspective of Austrian economists, we note, from the very beginning, that they base their approach on the interdependent relationship established between the amount of currency and the price level. They neither believe in the neutrality of money, namely the Keynesian approach, nor in the advantages of an expansionary monetary policy that could solve the problem of recessions, in accordance with the Monetarist vision. Therefore, Austrian representatives do not believe in the formulas associated to the quantitative theory of money and sharply criticize both the ensuing inflationary measures and the principle of price stability. **From their point of view,**

inflation rests at the stage of unnatural price growing, an increase which is not based on the sound principles of free market but **is induced by monetary expansion**; it may come from either central banks or commercial banks, operating with the system of fractional reserves.

Undoubtedly, the business cycle theory is one of the most vigorous Austrian contributions to economics. The traditional Austrian position regarding business cycles starts with the interdependent links that are established between price theory, capital theory and monetary theory.

According to Austrian economists, in the initial expansion phase of the cycle there is an increase in the volume of credit that floods the economy. This generally occurs by lowering the interest rate below its natural or wicksellian level, i.e., the one that would prevail in the absence of monetary fluctuations (Wicksell, 1898; Mises, 1963; Hayek 1935; Rothbard, 2008) and will subsequently cause an increased price level. Broadly, the business cycle can be briefly explained as follows (Rothbard, 2008): in a harmonious market economy emerges a credit expansion encouraged and promoted by the government and its central bank. As banks increase their money supply, both currency and deposits, granting loans to companies, they push the interest rates below the natural rate of time preference, meaning below the free market rate that reflects the proportions, freely coerced by public, between consumption and investment. The first visible effect is therefore a relative price increase of all the materials required for production. As the prices of production goods will grow ever more, the return on investment will tend to fall. If the credit expansion does not accelerate, the rising level of production goods prices will catch up the commodity prices, leading to a sharp decline in profitability. The crisis is triggered when, at the existing prices, producers cannot sell their goods (Mises, 1963, 1981).

The interdependence liaison established between the level of saving and that of investment, the central explanatory point of the Austrian theory of the business cycle seems to overlook both Keynes and Friedman. The first sees things completely different from the Austrians belonging to the Vienna School. The idea that stands as a basis for the "economist of the Great Depression" is that saving decisions belong only to individuals and depend on their income, while investment decisions are subject only to the expectations expressed by entrepreneurs. Therefore, if these expectations manifested by entrepreneurs, are positive, they will determine a higher amount of investment, and vice versa; if expectations are negative, there will be a contraction in demand that may cause depression.

For the second economist mentioned in the lines above, namely Milton Friedman, an increasing amount of investment can only be determined by an augmentation of money in circulation. Therefore, from a Monetarist point of view, the quantity of money is directly proportional with economic activity. Money injections lead the economy towards investments that generate prosperity, while a decrease in money supply lowers the return on investment thus leading to the emergence of imbalances.

The Austrian doctrine comes, however, to resolve, via a plausible system of argumentation, this apparent dilemma related to the type of relationship established between saving and investment. **The key is capital theory**; namely the intertemporal perspective on capital, an approach with a high explanatory power, which however is absent from both the Monetarist and the Keynesian doctrines.

Austrian approach – A sane perspective

The marginalist movement of the nineteenth century, although it has revolutionized the foundation of economic thought cemented until then, apparently failed to convince economics to borrow its basic principles. Therefore, nowadays, most economists still consider economic problems in terms of aggregates. We are thus entitled to envisage that the ideas on which the marginalist thinking was grounded remained yet misunderstood by some economists who seem to refuse to pervade the meaning of the reflection according to which, at the core, it is the marginal and not the total value the one that determines, in the first instance, the importance and, subsequently, the need for a good in production or consumption. The approach thereby becomes a "borderline" one as it is admitted the importance of the last unit belonging to a good, either owned, consumed or exchanged.

The architecture of the Austrian business cycle theory is based on six pillars. In the first instance, we are discussing about the *marginalist approach*. The second pillar is represented by the *methodological individualism*. Thirdly we discuss about the *methodological subjectivism*. The fourth pillar refers to the incorporation of *time preference structure* developed by Böhm-Bawerk, both in

terms of production and especially of consumption. Number five is the wieserian concept of *opportunity cost*. Last but not least, *market deregulation*.

With strong roots in Menger's *Economic Principles*, as well as in the precepts provided in the works of Böhm-Bawerk and Wieser, first Mises in 1912 and after, with significant improvements and contributions Hayek in 1933, were able to develop, in a very clear manner, the mechanism through which monetary expansion, accompanied by loans that exceed the rate of voluntary saving, could lead to a misallocation of resources, affecting, in particular, the structure of capital. Mises (1963, 1981, 2002) applied the approach based on methodological individualism and subjectivism to the monetary theory; Hayek (1933, 1935) used the same classical Austrian approach, to which he incorporated the monumental monetary demonstration designed by his contemporary Mises, making both adhere to the theory of interest. His theory betrays emphasis placed on the issue of time preference, but especially on the theory of capital, namely, the way in which monetary injections distort the allocation of capital within the production process. Thus, together, the two economists founded the Austrian business cycle theory, a complex and logical theory that once understood can represent a real saving treatment for the economy that chooses to apply it.

Monetary aspects of the Austrian business cycle

In light of the Austrian view, there are two ways in which investment can be financed. The first consists of people's voluntary savings reflected in the natural rate of interest and corresponding to the sustainable boom. The second refers to monetary injections reflected in a level of interest rate which is below the natural rate one and is included in the analysis of the unsustainable boom. The latter action can, in turn, be decomposed in monetary injections that come directly from central banks or the ones operated by commercial banks through the fractional reserve system.

Central banks are either, literally, printing money or choosing to lower the refinancing rate level, when facing the situation of saving commercial banks that operate on the principle of moral hazard.

Regarding commercial banks, these institutions have the legally accepted possibility to increase the quantity of money in circulation by creating credit based on demand deposits; this type, unlike time deposits may be withdrawn at any time and should be always kept 100% available to the depositors. Thus, „*The bank creates new money out of thin air, and does not, like everyone else, have to acquire money by producing and selling its services. In short, the bank is already and at all times bankrupt; but its bankruptcy is only revealed when customers get suspicious and precipitate "bank runs"* (Rothbard, 1990, p.27). However, in doing so, the bank is able to use the depositors' money for its own purposes and obtain profit.

According to Jörg Guido Hülsmann (Hülsmann, 2000), ideas that we encounter in de Soto's work also (Huerta de Soto, 2010), if we compare the banking system based on deposits with the fractional reserves based one, we observe that under the former system ownership is not transferred to the bank but still remains to the one who has the money, for example. In this case, the bank simply has to keep the deposit, to protect and return it to the depositor at any time he would ask. For time deposits the situation changes as the person is willingly transferring the ownership to the bank, for a certain period of time that is stipulated in the contract. Therefore, the bank gains the right to use the amount in its own interest, being though indebted to return on the due date the exact amount plus the accrued interest.

For a better understanding, we consider necessary a detailed explanation of the distinction between the two types of loans; we are discussing about the commodity credits, granted from time deposits and circulation credit, attributed from demand deposits. The importance of this classification is reflected by the ease with which it can be further clarified the concept of Austrian business cycle. Thus, commodity credits represent „... *transfers of savings from the hands of one who initially saved to the hands of entrepreneurs who intend to use these funds in production processes*” (Mises, 2010, p.124). It becomes easy to understand that this category of loans obtains its funding from delaying present consumption or, as formulated by Bohm-Bawerk (1889), from lowering the time preference manifested by a certain part of the population. In other words, it is precisely about the increased level of savings, the only healthy way to cover the loans granted through commodity credits. Thus, drawing attention, Mises states that „*Capital is not a gift from God or nature. His source is the individual who reduces consumption. It is generated, increased by savings and maintained by refraining from spending the saved resources*” (Mises, 1972, p.83). The volume of credit is, therefore, strictly limited

to the existing amount of savings. Banks only facilitate, through this type of loan, a transfer of purchasing power from the creditor towards the debtor; the latter accounts for the ability to acquire the necessary factors for undertaking a production process.

With respect to the circulation credit we find out that it is "... granted from bank funds specifically designed for this purpose. When granting a loan the bank prints banknotes or opens an account for the borrower in a deposit account repayable on demand. Credit is created out of nothing. It is the equivalent of newly created fiat money, thus of direct undisguised inflation" (Mises, 2010, p.124). Therefore, circulation credit does not get funding from the money that people have previously saved but represent, in the Austrian sense, a pure figment of banks, eager to obtain profit. The immediate effect of granting loans from this type of credit is an increase in the purchasing power of money that first gets into the possession of borrowers. Thereby, they come across the situation when they have a relative surplus of money and a relative deficiency of other goods. Likewise, these people possess monetary units, whose marginal utility has decreased, placing them in a stronger position as buyers. As a direct consequence, they will manifest their desire for particular goods in a more intense way, meaning they will be willing to offer more money in order to obtain them. We thus find out, from the Austrian economists, that the conspicuous consequence will be an augmentation in the price level of those much desired goods. By comparison, the objective exchange value of money will decline.

Therefore, the first inference that arises, by applying the first law of Gossen, namely that regarding the reduction of marginal utility and according to which "... every need reduces its intensity as it is being satisfied" (Popescu, 2011, p 29, apud Gossen, 1983, p.6) to the monetary theory, is that "... the higher the stock the lower will be its marginal use " (Wieser, 1893 p.viii). On the same line of reasoning, if the marginal use decreases in importance as the available quantity of good increases, and if precisely that importance of marginal use is what determines the marginal utility, this means that it is absolutely natural for marginal utility to decrease while available quantities increase. We have therefore our attention drawn to the fact that any augmentation in monetary units must be covered by an appropriate amount of goods, at whose acquisition participates as medium of exchange. The main consequence of the failure of this action will mark the beginning of a vicious circle in that it will cause a decrease in the marginal utility of the monetary unit, which, in turn, will lead to higher prices and, hence, on to numerous adverse consequences for economy.

Austrian economists therefore emphasize the need for apprehension of the idea according to which "*Every step toward prosperity is the result of thrift*" (Mises, 1972, p.45). This idea, initially encountered at the founder of the Austrian School, therefore at Menger (1867), and subsequently developed by the other members, highlights the need for awareness of the fact that the action of saving is, in fact, one of the pillars of a healthy economic environment without which prosperity cannot be known. Therefore, simulating the existence of funds needed to cover the loans granted to capitalists for starting economic development process is pure utopia. And that's because, according to the Austrians, through Mises, "... what limits the amount of savings and investment is time preference" (Mises, 1963, p.491). Consequently, when it will be realized that not changes in consumer preference (Bohm-Bawerk, 1889, Hayek 1935) are responsible for these investment turnovers but only cheap monetary policy (Mises, 1963, Huerta de Soto, 2010), the consequences will be most harmful for the proper functioning of the economic apparatus. And, sooner or later, this information will surface, assures us, in chorus, the Austrian economists.

The propagation of monetary errors within the production process

Continuing the incursion along the phenomena produced by the triggering of the Austrian business cycle, we find that borrowers are merely the capitalists eager to start production processes in hope of obtaining profit. Hence, they bid the needed production inputs with the money whose purchasing power is apparently higher due to monetary injections. An increased demand, which would not have emerged in the absence of newly created money, can be observed, resulting in a significant increase in the price level of those auctioned products. For Austrian economists the sequence in which the money enters the market reveals the emergence of a monetary asymmetry. This aspect represents an essential character for understanding the expansionist phenomenon and, from their perspective; it is the main evidence of the non-neutrality of money (Hayek, 1935).

Therefore, tracking the propagation of monetary errors throughout the production process can be easily observed with the help of the interest rate. Thus, „*Hayek's critical contrast between the*

intertemporal coordination that can be achieved by the free play of the market and the intertemporal discoordination that results from the manipulation of a key market mechanism, namely, the interest rate....” (Garrison, 2006, p.6). From this point of view, the interest rate is the price of time stemming from the loan funds offer, thus from the people who save, and the demand for loan funds, thus towards investors. Huerta de Soto finds the inspiration to state that *“... from the Austrian point of view, the interest rate represents the market price of present goods in terms of future goods”* (Huerta de Soto, 2011, p.84-85). Therefore, sacrifice requires a reward so that the amount paid to these individuals is nothing but the interest granted for the entire period of time in which their savings were used in a productive way, namely in profitable investment. If the public manifests the desire to save more, this action increases the supply of lending funds, pushing down interest rates and encouraging lending, thus investment. This theory is consistent with the ability of markets to self-regulate, by allowing the conveyance of signals on consumers time preferences. Hayek (1933, 1935) saw this process as ensuring a good intertemporal coordination as the low time preferences of depositors determine, in the first instance, a decrease in interest rates. This particular action assumes the lengthening of production processes, thus of investments exhibit in higher order capital goods.

Hence, according to the Austrian theory, any augmentation of the volume of household savings reduces present consumption, leading to a decrease in the relative price level of consumer goods, so as to: *“...the influence of money on prices and production is quite independent of the effects on the general price level. But it seems obvious as soon as one once begins to think about it that almost any change in the amount of money, whether it does influence the price level or not, must always influence relative prices”* (Hayek, 1935, p.28). Consequently, there is a higher demand for capital goods due to an increase in real wages; therefore we are discussing a lowering in consumer goods prices, namely the output obtained from the funds that have as a basis the voluntary savings of the population.

Further, there can be observed a relative increase in entrepreneurial earnings corresponding to the most remote stages of production from the final consumption. The result of the aggregation of these configurations can be translated, in hayekian terms, by an elongation of the structure of production that becomes a more capital intensive one; it is precisely due to the involvement of a higher amount of resources saved by population.

However the problem for the Austrian economists arises when exogenous factors can be detected, such as government monetary injections performed by central banks or credit injections manipulated by commercial bank agents that, without the support from the savings provided by individuals, become creators of inflation. The new money, created out of thin air, are thus provided to entrepreneurs, penetrating the economic system as seemingly real and profitable new investments, leading capitalists into building their plans based on a distorted picture of reality. Therefore, businessmen come to behave as if the rate of savings has increased considerably; however, in reality this is far from being realized (Hayek, 1935).

Thereby, newly created money floods the market, primarily, as a consequence of the lower level of interest rates, below the natural one, leaving a touch of apparent profitability to some businesses, hitherto, had no profitable prospects.

The new money, once they reached the market, determine a relative increase in the costs resulting from the placement of funds within the productive process, subsequently leading to an increase in input prices. The immediate following result is the orientation of production towards new and more capital intensive production processes.

All of this can be translated into an augmentation of demand for the resources usable within the production process, therefore a lengthening of the structure of production. Consumer goods segment records a lower level of relative revenues resulting in a cost increase tendency by comparison with the price level that records decreases. What happens, says Hayek, is a transfer of capital goods from the sectors closest to the consumption towards the most capitalistic ones.

An increased request for final goods eventually begins as a consequence of enhancing revenues collected by the owners of production factors. As their incomes rise, they will determine an increasingly higher demand for final products, which will result in a higher general price level. This rise, however, is determined, primarily, by an augmented money supply in circulation; and, moreover, the essential problem that occurs here is that the prices of capital goods used in the production of output, whose demand has progressively increased, will tend to grow faster than the latter, reaching or

even surpassing them, and thereby causing a sharp drop in investment profitability. Thus, the reallocation of capital goods that were originally assigned for longer and more productive production processes will be transferred to the stages that are closest to final goods production, with the risk that the prices invested for the purchase of such capital goods are not covered by the prices to be obtained for the final output. Over time, and without further injections through a low interest rate, entrepreneurs will be forced to declare the bankruptcy of their business. The above mentioned actions have, as a consequence, the establishment of massive unemployment and the triggering of recessions.

Conclusion

As it was well observed by Adam Smith in his primary work *Wealth of Nations*, a country's capital growth and the achieving of social progress is obtained through savings and accumulation of productive resources. He is also among the first economists who noticed the connection that is established between the development of a nation and the state of national wealth, understanding through wealth the capital accumulated through savings.

Keynes, one of the leading economic figures of the XXth century, however, believed that investing and saving are two independent decisions, unrelated to each other. The Monetarist vision recognizes the importance of interest, in opposition however to the Austrian perspective. According to the Monetarists, a low interest rate helps investors by encouraging them and marking a free path towards investment; therefore this leads to the development of a nation. By contrast, a high rate of interest will boost savings of population, which will be to the detriment of a good economic development.

From our perspective, Austrian economists succeed the closest correlation between theory and reality. They are against a reckless consumption and come to defend savings. Their approach is relevant and contains a considerable dose of truth as only through savings can clean capital be accumulated; the type that is so necessary for healthy investment. All this will lead, over time, to progress. Crises will thus be avoided.

Hence, in a healthy Austrian environment, investments are financed from loans granted by banks on the basis of funds raised from the voluntary saving of population. We are referring to time deposits, i.e. the money that people willingly and consciously give up, in exchange for the benefits obtained from interest. Thus, by granting loans created virtually from nothing, namely, without coverage in household saving funds, entrepreneurs will be provided irrelevant information on consumer preferences, leading to bad investment that will eventually prove, unprofitable.

It is therefore beyond doubt that recessions do not actually represent a market failure, as many economists believe; according to the Austrian economists these are errors caused by government intervention through the banking system. From their point of view, only a free market can react to the aggressions generated by credit expansion. The way in which it can do so is through crises that come to cure the economy of all negative repercussions left behind by the inflationary impetus. Thus, when exogenous factors such as expansionary policies interfere, economic relations are distorted, marking the path towards the triggering of imbalances.

From the Austrian point of view, a crisis will only disclose the unleashing of economy from any type of disturbing factors, thus indicating recovery through readjusting production processes to the true market structure; in other words, to the real demand of the sovereign consumer. Likewise, what must be well understood is the fact that depression does not represent the result of renouncing to the expansionist policy. On the contrary, it can be viewed as the ineluctable consequence of such a policy. The recovery process can be initiated only when the economic environment managed to remove the causes which have determined its illness in the first instance, i.e. when monetary injections are suspended.

As a corollary, what Austrian economists, starting with Menger and continuing with the ones belonging to the contemporary period, wanted to share with us is, first, the fact that a good understanding of the concept of marginal value, to which the subjectivist-individualistic methodology is added, can shed light upon the business cycle theory. Analyzing the monetary, capital and interest theories through these filters can lead to discerning, in the first phase, the micro horizon of the cycle, in order to subsequently assimilate the macroeconomic one.

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THE COMPETITIVE ANALYSIS - THE APPROPRIATE INSTRUMENT TOWARDS A SUCCESSFUL DEVELOPMENT

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Abstract:

Albania is a country with a long period of economic and social transition. To many industries are growing during this period. So, the relationship between competition and challenges for a sustainable growth of firms remains a basic argument for development of policies, strategies and adapting to strategic changes. Today's competitive situation among companies, characterized by globalization, and the need to survive has lead to an urgent need for competitiveness management. The concept of competitiveness is an important element in the debate on the performance of nations, industries and firms. Also, it is vital for industries and companies to increase the knowledge and understanding of competitiveness. In order to formulate strategies for competitiveness, managers need to know what are the competitive strategies they have to use, which are the variables that affect the expected results, how are they correlate each other. In order to be able, to adapt and develop within an industry, companies have to build the appropriate infrastructure through which it is possible to understand and measure the indicators such as attractiveness of the industry, competitive rivalry, industry positioning and strategic choices. The principal aim of this paper is to make an evaluation and to analyze the issues concerning the competitiveness conception. The paper is structured in two main parts related with: Understanding the competitive analysis and Strategic choices that companies use to be successful. According the purpose of this work there are following the description and comparative methods.

Keywords: Competitiveness, strategic choice, industry, development

Introduction

Today's competitive situation among companies, characterized by globalization, and the need to survive has lead to an urgent need for competitiveness management. The concept of competitiveness has been largely accepted across all industries and countries since Porter published "Competitive Strategy" in 1980. It is vital for nations, industries and company level (Moon *et al.*, 1995) to increase the knowledge and understanding of competitiveness. In order to formulate strategies for competitiveness, managers need to know what are the competitive strategies they have to use, which are the variables that affect the expected results, how are they correlate each other. There is a gap about the researches how the Albanian companies choose the strategies they have to compete. Do these businesses use any method analyzing the advantages that flow from each competitive strategy?

Understanding competitiveness and competitive strategies

While talking about competitiveness, the main question is "What is the competitiveness? In order to develop, implement and monitor any initiatives for improving competitiveness, first, there is a need for a framework through which competitiveness can be defined, measured and understood. Competitive positioning defines a firm's relative position in competitive space. It enables a firm to create a defensible position by compiling and choosing the strategies based on the firm's strengths and weaknesses, and on opportunities and threats imposed by the competitive space (Porter 1980, 1985). Competitive space such as the industry in which a firm operates, can be defined by some variables simultaneously and their different combinations (Hofer 1975). Porter argued that "Competitiveness remains a concept that is not well understood, despite widespread acceptance of its importance". Nowadays, there are many definitions for this concept. According to Lu (2006), "The competitiveness

is a concept more powerful than traditional economic indicators such as profitability, productivity or market share". This definition seems to be coherent with the one presented by Flanagan et al., (2005), according to whom the competitiveness refers to an objective - a high, rising standard of living for its citizens and high, rising returns on investment to its owners respectively. On their turn, Waheeduzzan and Ryans (1996) point out that competitiveness belongs to the eye of the beholder (it means different things for different people). Besides those elements, competitiveness is also related to high productivity, profitability (Flanagan et al., 2005), innovation and value for shareholders (Momaya and Selby, 1998), among other qualities. In summary, as stated by Flanagan et al. (2007), the ultimate purpose of competitiveness is to improve and achieve a better long-term performance for firms.

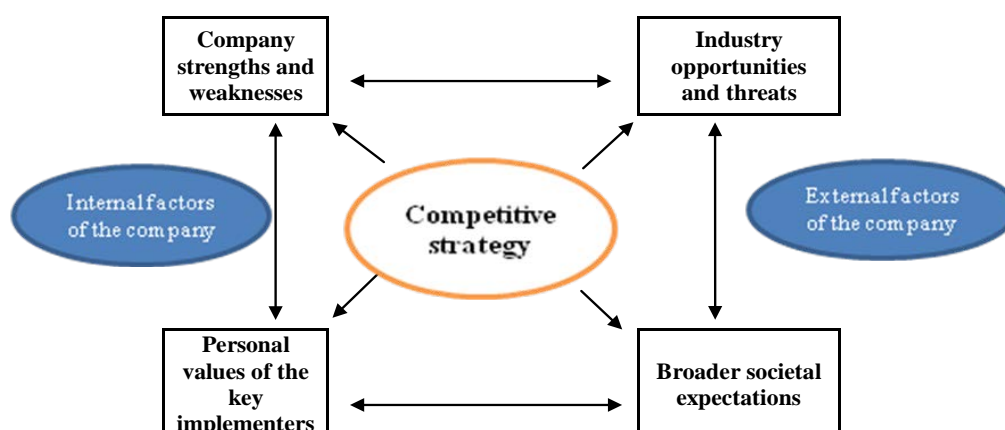
Another definition is developed by Momaya and Selby (1998). Based on their definition of competitiveness in terms of financial performance, they argue that "the first component of sector competitiveness may appear quite satisfactory from the perspective of an investor; however, it can fail to recognize viewpoints of some of the important stakeholders within the industry". The industry competitiveness is given as the extent to which a company satisfies the needs of customers from the appropriate combination of the product/service characteristics such as price, quality, innovation, satisfies the needs of its constituents and offers attractive return on investment and the potential for growth" (Momaya and Selby, 1998).

According to Porter arguments related with competitiveness, companies can adopt the generic strategies for a competitive position within an industry using the integration of two dimensions: mode and scope of competition. The *mode of competition* refers to a firm's decisions on the method of developing competitive advantage while the *scope of competition* refers to a firm's decisions on the breadth of its operations.

Porter states that firms can adopt one of several strategies to defend against and outperform their competitors. The most notable of these strategies are cost leadership and differentiation. Porter posits that successful firms will typically adopt no more than one of these strategies because each strategy requires total commitment from the firm. *The cost leadership* strategy implies that a firm emphasizes low cost relative to its competitors by adopting tight cost and overhead control, avoiding marginal customer accounts, minimizing cost across the departments, and conducting operations and activities in an efficient manner. *The differentiation* strategy implies that a firm offers something unique and different by its competitors, and valued by the industry, which enables the firm to put higher prices than industry average.

Porter proposes that successful firms follow one of these two modes of competition, and suggests that the firms that attempt to follow a hybrid approach, combining both cost leadership and differentiation approaches, cannot achieve above industry average performance. Firms employing a mixed strategy are expected to exhibit subpar performance compared with other firms in their industry due to their lack of focus and commitment to a single, overarching strategy for their firm (Parnell, 2006; Porter, 1980).

Thus, Porter's generic competitive strategies theory have played an important role linking firm's competitive position and its organizational performance as well as to categorize firms by the strategies they employ. But, deciding which the most appropriate strategy is, it is needed to analyze the industry the company take part. The industry analysis model proposed by Porter takes into account the action of five forces: the rivalry among competitors, the threat of entrants and substitutes and the bargaining power of suppliers and buyers. Nowadays, the evolution of Porter theories refers to the existence of a sixth force. The sixth force would be the level of cooperation of complementary products or the role of government, which as a regulatory agent influences the sectors results. These agents were developed more at the double diamond of Porter. The importance of the industry analysis should also be emphasized because competitive, according to Porter, only offer higher gains if they are sustainable in relation to competitors of an attractive industry and have acceptable entry costs. According to Porter (1986), "Competitive strategy aims to establish a profitable and sustainable position against the forces that determine industry competition". Thus, there is a combination of external (industry level) and internal (search for competitive advantage) issues. The figure 1, clearly justify that the essence of formulating competitive strategy is relating a company to its environment from which the company generates the strengths, weaknesses, opportunities and threats. The analysis of the external and internal factors improve the company choosing the best competitive strategy.

Figure no.1 Context in which the competitive strategy is formulated

Source: Competitive strategy: techniques for analyzing industries and competitors. Porter 1980

The evolution of generic strategies

The focus of the paper besides the evaluating the competitiveness concept, deals with the conceptualization and the adoption the competitive strategies such as: the low cost strategy and the differentiation strategy proposed from Porter in his theory. According to Porter (1985), “a firm will ultimately reach the point where further cost reduction requires a sacrifice in differentiation. It is, at this point. that generic strategies become inconsistent and a firm must make a choice”. This debate has centered on whether the low cost strategy and the differentiation strategy are mutually exclusive or whether they can be adopted simultaneously.

On the one hand, it has been proposed that efficiency and differentiation are generally incompatible (Dess and Davis, 1984; Hambrick, 1983; Nayyar, 1993; Parker and Helms, 1992; Porter, 1980, 1985). Hence, for higher business performance, either the differentiation or the low cost may be adopted as primary strategy, not both. Also Hambrick (1983) has excluded the possibility of firms competing with more than one strategy. Accordingly, “the characteristics of an environment limit the range of maximally feasible strategies, such that it simply is not accurate to say that all generic strategies are equally viable within an industry”. Hambrick argued that the low cost strategy would be unlikely to be found in a dynamic industry environment. On the other hand, it has been argued that, for higher business performance, both the differentiation strategy and the low cost strategy may be adopted simultaneously (Buzzell and Gale, 1987; Buzzell and Wiersema, 1981; Hill, 1988; Miller and Friesen, 1986a; Murray, 1988; Phillips *et al.*, 1983; White, 1986; Wright, 1987). According to these authors, the adoption of the differentiation strategy would entail promoting higher product quality. The quality of the product would likely channels higher market demand to the firm competing with differentiation. Higher market demand allows the firm to assume greater market shares, which would lower production costs due to scale/scope economies. In other words, differentiation influences profitability indirectly by its positive effects on market share. Some of the authors which supported the second school argued that some leading enterprises tend to combine low-cost production with higher transaction costs to simultaneously achieve low cost and differentiation. Similarly, Hill (1988) has proposed that differentiation may permit a firm to achieve a low cost position. The differentiation effect in the short run leads to unit costs growth. However, if costs fall with increasing volume, the long-run effect may be to reduce unit costs”. Also, Phillips *et al.* (1983) found a significant and positive relationship between product quality and market share. Since increased market share allows lower production costs due to scale/scope economies, the study suggested that differentiation may be a fundamental way to lower a firm’s cost position.

There is another step in the evolution of Porter theory which refers to Mintzberg’s changes. According to Mintzberg (2001), the generic strategies should follow a logical sequence that starts at

the creation of the business, observing the demands and constraints of its specific business segments within an industry. The changes proposed from Mintzberg (2001) characterized the way a firm competes such as quality, design, support, image and prices. In other terms these elements can be defined and divided in accordance with the strategy of differentiation or cost leadership. Therefore, out of the generic strategies proposed by Mintzberg (2001), it is important to analyse the industry environment and how to compete which resemble Porter's view (1986) to adopt competitive generic strategies in accordance with the industry competitive forces.

On the other hand, Treacy and Wiersema (1995) proposed three forms of generic strategies to achieve and maintain leadership: operational excellence, product leadership and customer intimacy. These disciplines may be understood as generic strategies, since according to them, "the choice of a value discipline shapes the company's subsequent plans and decisions". Like Porter, they argue that no company can succeed today by trying to be all things to all people". According to them, the operational excellence is similar to Porter's cost leadership, but it is not limited to it. In the operational excellence, there is a combination of quality, price and ease of purchase that no one else in their market can match. The product leadership represents the continuous search for the best product which pushes the company into the realm of the unknown. This approach is very similar to Porter's differentiation strategy. The intimacy with the customer focuses on delivering not what the market wants, but what a specific customer wants. However, Treacy and Wiersema further explain their requirements: long-term vision, obsession with the pursuit of specific solutions, decentralization of decisions, valuation of results in selected customers, the long-term relationships and talented, flexible and multifunctional people. Porter only emphasizes the orientation with characteristics of differentiation and cost leadership in a business with determined focus (customer segment). For Treacy and Wiersema (1995), it does not aim to seek the lowest price or the best features, but an offer that allows the exploration of the customers. Firm's profitability goes through the increase in the number of customers and the participation on such customers' expenses. This approach by Treacy and Wiersema (1995) is similar to differentiation, but they emphasize aspects related to the customer.

Hax and Wilde (2001) developed another step in the evolution process of the generic strategies. Based in three strategies and supported by the concepts of best product, customer total solution and the system lock-in they tend to improve the competitive strategies. The best product strategy refers to the competition based on the economics of the product, and may follow strategies of cost leadership or differentiation. According to them, if there is an ambiguous situation of cost leadership and differentiation, the position will be weakened, as advocated by Porter (1986) and supported by Treacy and Wiersema (1995). The total customer solution refers to the competition based on customers' economics which requires a deep understanding of their needs, offering a good package of products and services and an integrated supply chain, including suppliers and customers. This approach has similarities with the focus differentiation strategy from Porter (1986) and similarly to the customer intimacy strategy by Treacy and Wiersema (1995). In the system lock-in, the system is considered as a whole, not only concerning with products or consumers, but including suppliers and complementors. The purpose is to achieve success with the lock-in of agents that contribute to the value expansion (complementors), the lock-out of competitors, by attracting buyers.

The impact of generic strategies to the business performance

The performance is a multi-dimensional concept, which implies multiple performance indicators. Dess & Robinson (1984) have also studied both financial and non-financial measure of organizational performance. Although "Porter discusses performance almost exclusively in terms of return on investment" (Miller & Dess, 1993), researchers have used a wide variety of both subjective/objective and financial/non-financial measures to quantify a firm's performance. However, Allen and Helms (2002) state that performance is often measured in three dimensions – effectiveness, efficiency, and adaptability, but the measurements of these dimensions has led to very little consensus in the literature regarding the linkages between firm strategy to performance.

Despite the different strategies mentioned above, they all aim to maximize the performance of an organization improving its competitiveness in relation to its competitors in the same competitive environment (Feurer & Chaharbaghi, 1997). So, the generic strategies require a specific set of characteristics and resources. Cost leadership requires the construction of facilities for high production volumes, the pursuit of cost reductions through learning and experience, a strict control of costs and general expenses, cost reduction in areas such as research and development, technical

support and sales force and a low cost distribution system. In differentiation, the firm's reputation as a quality or technology leader, strong cooperation from channels, great marketing skills, product engineering and basic research are very important (Porter, 1986).

The results of some empirical researches suggest there are significant differences in the configuration of variables by organizations adopting different generic strategies. There are also significant performance differences across generic types.

The firm would be in disadvantage in the competition with companies that clearly go for low cost or exclusivity, as it would not be able to develop an offer cheap enough to appeal to price-sensitive consumers, or exclusive enough to attract sophisticated ones. Since costs, prices and configurations would not be adjusted to specific targets, the profit potential would be adversely affected. Porter says that for firms that achieve both cost leadership and differentiation "(...) the rewards are great because the benefits are additive (...)". In this case, however, we see the strategic choice for differentiation (premium prices) with cost leadership in the background.

Conclusion

Although some firms into an industry may be able to perform well if they primarily compete with the low cost competitive strategy such as: cost advantages, low prices, the expectations are: businesses which stress only the low cost strategy would not perform very well, whether they are smaller or larger in their industries. The justification for this expectation is that companies, which choose to compete only on the basis of lower costs and prices, would have their profit margins under pressure. Consequently, managements' abilities to implement measures to improve outputs, or augment products with superior services or to expend more on marketing activities are limited. Hence, these companies remain vulnerable to competitor moves that may draw customers away from them. A strategic tendency, in this event, might be to further lower prices, which would put even more pressure on profit margins. Consequently, long run prospects of business units which compete solely with lower costs and prices may not appear promising.

Although some firms into an industry may be able to perform well if they primarily compete with the differentiation strategy, the expectations are: businesses which stress only the differentiation strategy would not perform very well, whether they are smaller or larger in their industries. The justification for this expectation is that companies which choose to compete only on the basis of differentiation, whereas not stressing low cost operations, may be vulnerable to competitors that have lower cost positions and may offer similar outputs with a good price. It is possible that the threat of substitute products is greater for such companies.

So, the firms which simultaneously compete with the low cost strategy and the differentiation strategy to perform well, because they would likely benefit by achieving greater profit margins, whether they are smaller or larger in their industries. With the evolution of porter theories, the industry dynamics and the positions in the life cycle curves of products and businesses may allow the business continuity through differentiation, even with less attractive margins. In addition, the cost-benefit is applicable to any level of products, services and prices, and the firm must assess its relevance.

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INTERDISCIPLINARY APPROACH TO MEASUREMENT OF WELL-BEING ³³

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Abstract

The global financial crisis brings a crisis of confidence in the traditional ways of measuring welfare and economic performance. The current methods do not sufficiently take into account the problem of speculative risks, environmental expenses, ethics and subjective well-being. So far, the standard indicators are considered as insufficient tool of measurement of economic performance and welfare. Economic well-being is a broader concept than GDP, it contributes to categories such as leisure, wealth, non-market activities. On the other hand, welfare is reduced by uncertainty and unemployment. The role of measurement of well-being is not to replace GDP, but the indicators related to well-being, happiness, social development should be an important supplement in order to provide greater insight into the functioning of society. Economics of happiness focused on links between economics and other disciplines, such as psychology and sociology. The paper deals with GDP limits, the concept of happiness and alternative approaches to measurement of individual well-being.

Key Words: Economics, happiness, well-being, GDP

Introduction

The ancient philosophers like Democritus, Socrates, Aristoteles dealt with the category of happiness in the past. Eudaimonia, preferred by these scholars, is an ethical and philosophical doctrine with morality as a main criterion. The moral basis of human behavior is the desire for happiness - personal or social. Psychology defines happiness as an emotion, or feeling, which is associated with both satisfying basic physiological needs such as the need to breathe, eat, drink, sleep, etc., but also the satisfaction of higher needs related to interpersonal relationships, values, thinking, experiencing beauty and culture. The paper deals with various aspects of economics of happiness as a new interdisciplinary approach to economic theory.

Arguments in favor of a new approach:

One of the lessons learned from the global crisis is a critical review of economic indicators used. GDP is not an adequate indicator to measure the socio-economic development and well-being of society as a whole. It does not reflect the real performance of the economy.

R. Dornbusch and S. Fischer describe the problems that have been associated with the use and interpretation of the GDP as a macroeconomic indicator: "*GDP data are, in practice, used not only as a measure of how much is being produced but also as a measure of the welfare of the residents of a country. Economists and politicians talk as if an increase in GDP means that people are better off. But GDP data are far from perfect measures of either economic output or welfare.*"³⁴

GDP has four major limits that reduce its possibility of measuring welfare. First, GDP includes replacement of amortized capital. Amortization does not encourage prosperity and replace

³³ The paper was elaborated with the support of grant VEGA no. 1/0761/12. The paper was elaborated within R&D project's titled "Creating Excellence Centre for Economic Research to address the challenges of civilization in the 21st century" (no.ITMS 26240120032). Project is co-financed by the EU.

³⁴ Dornbusch, R., Fischer, S. et al.: Macroeconomics. McGraw-Hill, N.Y., 2008, p.36

worn-out capital. This means that this part of GDP do not contribute to benefit of consumers because it is the only compensation for physical capital.

Second, GDP measures the income generated in the country, but not the size of the income, which remains in the country. Part of the income goes to foreign entities. In other words, foreign entities have significant benefits from an increase in GDP of domestic country.

Third, GDP is based only on monetary transactions. It does not include many other activities eg. care for children or elderly people in their own home. GDP also ignores the value of leisure time spent relaxing with family or friends. It does not include the value of clean air and water, unpolluted environment. Some outputs are not traded in the market and therefore they are poorly measured.

Fourth, GDP includes many items that do not encourage the well-being of people. If a natural disaster such as an earthquake damaged country, the damage and restoration of the original state of the country is seen as stimulation of GDP growth. Expenditure on health as a result of air pollution, or the costs of antidepressants are also included in the GDP.

GDP does not take into account welfare and happiness. Economic well-being is a broader concept than GDP, it contributes to categories such as leisure, wealth, non-market activities. On the other hand, welfare is reduced by uncertainty and unemployment. Economic well-being has a uneconomical dimension such as good health and education, a clean environment, security in cities etc. These factors contribute to the overall well-being of the individual, but it is difficult to quantify these factors. Nevertheless, they are considered so relevant that they should belong to the priorities of economic policy in the social-market economies. The role of measurement and evaluation of well-being is not to replace GDP, but the indicators related to well-being, happiness, social development should be an important supplement in order to provides greater insight into the functioning of society.

Scheme 1: Elements of happiness and welfare

HAPPINESS:	WORKING CONDITIONS :	ECONOMIC WELFARE:
Genetics	Environment	Leisure
Family	Health	Wealth
Activities	(Inequality)*	Non-market activities
Friends	Education	(Unemployment)
Job Satisfaction		(Uncertainty)
Social contacts		

* Words in brackets represent a negative impact

Source: Deutsche Bank Research, p.3

In recent years the category of happiness has become a new concept in economic theory. The concept of economics of happiness focused on links between economics and other disciplines, such as psychology and sociology. The idea of happiness is not a new one. T. Jefferson claimed the right to happiness belongs to the fundamental rights of citizens equivalent to the right to life and freedom. The right to happiness is listed in the Declaration of Independence of the United States of America as one of the three fundamental rights along with the right to life and liberty.

D. Nettle distinguishes three concepts of happiness:

- currently feelings of joy and pleasure. These feelings are often called happiness.
- overall satisfaction with their lives
- quality of life stemming from the fulfillment of an individual potential, which can be described as a "good life".³⁵

Happiness is undoubtedly considered as one of the most preferred targets of human life. In the last decade the economics began to deal with a phenomenon happiness. The origins of this concept, however, are considerably older. J. Bentham, a founder of utilitarianism (based on neoclassical economics), deals with the concept of happiness while makes a distinction between individual and social happiness. He claims that the responsibility of government is to ensure the highest level of happiness for the greatest possible number of people. The current concept of economics of happiness is more developed but the basic theoretical framework has been still based on neoclassical economics.

³⁵ Nettle, D.(2005):Happiness. The Science Behind Your Smile. Oxford. In: Frey, B. et al.

Many current approaches require a broad base combining indicators of socioeconomic factors (individual income, employment status, education, etc.) and macroeconomic factors (GDP per capita, inflation, unemployment, foreign investment, etc.) and finally, institutional and political factors (political freedom, corruption, etc.). These concepts work with a number of indicators that assess and measure different dimensions, not only economic ones. Therefore these indicators can be described as multidimensional ones.

Although happiness by its very nature is very difficult to measure, most studies provide valuable insights into the level and determinants of overall life satisfaction of individuals (Romina, Johansson 2006, Frey, Stutzer 2002; Kahneman, Krueger 2004, Layard 2006).

The first country that started with monitoring of happiness in terms of Gross National Happiness was Bhutan and it was already in 1972. Since then, the index has undergone many changes, but the country continues to use it and publishes an annual report on its progress. It is composed of several sub-indicators, which are divided into the following dimensions:

- Psychological indicators (life satisfaction, emotional balance, spirituality);
- Health (not only physical but also mental health);
- Education (literacy, quality of education, knowledge and values);
- Culture;
- Use of time (working hours, time spent sleeping);
- Government (participation in politics, political freedom, public service, performance of government);
- Social vitality (social support, social relationships, family, crime);
- Ecological diversity and resilience (pollution, environmental responsibility, wildlife, urbanization);
- Living standards (income, assets, housing quality).³⁶

In recent years a Happy Planet Index (HPI) has been introduced. This particular index was constructed in 2006. HPI is composed of three sub-indicators: perceived well-being (happiness), life expectancy and ecological footprint. Welfare (or happiness as was mentioned above) is measured by means of questionnaires, which questioned respondents about their quality of life, general life satisfaction and well-being. The ecological footprint is an indicator reflecting the consumption of resources required to maintain the country's consumption.³⁷ Critics of this approach point to the various imperfections of this concept. Specifically, used indicators are considered to be too subjective and thus the governments can define and then measure them according to their interests. Another weakness of these indexes is the subjectivity of the data itself and data received from the respondents' answers.

Measurement of well-being and optimal functioning of the economy, however, can be problematic for other causes. This type of indicators is to some extent influenced by the "subjective view" of what is considered a functioning society, i.e. what parameters will define the well-being of society. Even if there is a consensus on what constitutes well-being of the society, recording of well-being may show signs of normative economics - subjectivism (Norberg, 2010).

Conclusion

Research devoted to the problem of happiness have shown that the subjective feeling of satisfaction expressed much better individual well-being. It should be noted that the concepts as happiness, individual well-being, subjective feeling of satisfaction are considered as synonyms in the relevant economic literature.³⁸ Happiness research helps to understand the formation of not only subjective - individual happiness but society welfare as well. Moreover happiness research can help to clarify the empirical paradoxes such as the fact that in many countries, despite a significant increase in income, subjective well-being perceived by individuals is not increased respectively is slightly declined. New approaches to measuring performance and well-being of the whole society requires

³⁶ URA, A. et al. 2012.

³⁷ www.happyplanetindex.org

³⁸ FREY, B. et al.: Concepts of Happiness and Their Measurement. In: Jahrbuch Okologische Okonomik. Metropolis Verlag, 219-237

consensus on the necessary assumptions and parameters what welfare means in terms of society, additionally it is required to define the conditions for sustainable development.

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DEFAULT AND FRAGILITY IN THE PAYMENT SYSTEM

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Abstract:

I present a model of the payment system where agents may choose whether or not to default on debt. Our model also features debt-financed purchases of goods, unsecured debt cleared through third parties, and debt settlement requiring final payment using fiat money. I compare the merits of three alternative settlement rules: a strict net settlement rule, a net settlement rule with debt forgiveness and a gross settlement rule. I find that net settlement is superior to gross settlement and that only a net settlement rule with debt forgiveness gives the correct incentives for a unique, stable and optimal stationary equilibrium.

Key Words: Default, payments system

Resumen:

Presentamos un modelo de sistema de pagos donde los agentes pueden elegir si desean o no dejar de pagar la deuda. Nuestro modelo también cuenta con compras de bienes financiadas por deuda, la deuda no se garantiza a través de terceros, y el pago de la deuda requiere un pago final usando dinero fiduciario. Compararemos los méritos de tres reglas de solución alternativas: una regla de liquidación neta estricta, una regla de liquidación neta con perdón de deuda y una regla de liquidación bruta. Encontraremos que la liquidación neta es superior a la de liquidación bruta y que sólo una regla de liquidación neta con perdón de deuda da los incentivos correctos para un equilibrio único, estable y óptimo.

Introduction

What are the optimal rules for the settlement of debt when debtors may choose to default? Gross settlement? Net settlement? Or net settlement with debt forgiveness in times of crisis? Which of these settlement rules generates stationary equilibria that are unique, stable, and optimal?

This is not an obscure operational question. In modern economies, most personal and business purchases and all financial transactions are conducted with debt, from credit cards and personal checks to large institutional wire transfers, not with fiat money. In general, these transactions are cleared and settled in central clearinghouses and all go through the Central Bank system. In the U.S., CHIPS and Fedwire are the largest of these central clearinghouses, and all their transactions go through the Federal Reserve System in one way or another. In particular, every day, Fedwire and CHIPS together settle close to \$4 trillion in debt (if not more,) with only \$47.6 billion in pre-funding (transferable deposits.) The latter implies a velocity of 228.57, even though CHIPS argues that its own velocity is over 500³⁹. The absolute and relative scale of these transactions, together with the high

³⁹ Another helpful point of comparison is against the value of economic activity: the annual GDP in the U.S is close to \$13 trillion, and thus, the value of the GDP would be exhausted in only 3.25 days by transactions in the payments system.

level of coordination observed among banks⁴⁰, mean that a problem that starts and/or affects a member of the Payment System could be eventually transmitted through associated banks, generating a liquidity crisis in the system that could lead to systemic failure. Under such circumstances, the rest of the economy would be affected significantly as well, producing chaos as a byproduct that could only worsen the problem.

The importance of a healthy Payment System, particularly in the U.S., can be seen in the essential role of the elastic provision of intraday liquidity by the Federal Reserve System in times of crisis, as for example in the Crash of October 1987 and September 11th of 2001. Clearly, without a well defined payments system through which implement the so much needed monetary policy, the effects of such crises would have been even more devastating.

Previous theoretic analysis of settlement issues often presumed perfect enforcement [e.g., Freeman (1996), Lacker (1997)] or exogenous default probabilities⁴¹ [Freeman (1999), Fujiki, Green and Yamazaki (1999), Freixas, Parigi and Rochet (2000)]. Rochet and Tirole (1996), Angelini (1998), Kahn and Roberds (2001) take an additional step and study the moral hazard introduced by the provision of credit during the settlement process –agents whose assets are accepted as payment will acquire riskier assets than is optimal. In this important line of research agents do not choose whether to default; default occurs only when forced by low asset returns.

As Zhou (2000) has argued persuasively, these are good but not yet sufficient guides for settlement policy. Without modeling the decision of whether to default or not, we cannot discuss the effect of settlement rules on incentives to default and how default decisions may be strategically interdependent and may thus threaten the stability of the payments system. What induces the repayment of debt, and how does the repayment decision depend on the actions of others? How are these decisions affected by the rules of settlement?

We take up Zhou's challenge and study the settlement risk of non secure debt contracts where delivery versus payment (DVP) is not possible, and agents may choose nontrivially not to deliver promised payments, especially if they believe that others will do likewise. In this form of settlement risk, agents who suspect that they will not be able to collect on IOUs receivable may have less reason to repay IOUs payable, a strategic complementarity that may lead to the instability and multiplicity of equilibria and even the collapse of the payments system. Most of the previous work⁴² has emphasized the disadvantages of Net Settlement, and has implicitly assumed that all transactions in Gross Settlement were DVP. It is our intention to demonstrate the clear advantages of Net Settlement in the absence of DVP.

To address these questions, we build on a basic payments model [Freeman (1996)], which features as implications debt-financed purchases of goods, debt cleared through third parties (central clearinghouses,) and debt settlement requiring final payment using fiat money. In this setup, there is incomplete contract enforcement: there is no collateral and DVP is not possible, which leads to increased counterparty risk. To this we add a nontrivial default option: after issuing and receiving debt, agents may choose whether to relocate inside or outside of the reach of the collection efforts, an action that relieves them of the need to repay debts, but which limits their own collection of debts receivable and may entail other costs. The inherently intertwined nature of the repayment and collection of debt introduces potential strategic complementarities. In particular, default is an equilibrium outcome and it may be optimal or not, depending on the settlement rule in place.

⁴⁰ According to McAndrews and Potter (2002), 63% to 76% of banks' payments depend on receipts from other banks.

⁴¹ It can be argued also that in this collection of papers, there is a temporary failure to repay that is fixed later in the period, and not default in the strictest of terms.

⁴² See Kahn, McAndrews and Roberds (2003.)

Using this framework we evaluate the welfare and stability properties of three settlement rules: gross settlement, strict net settlement (with unwinding), and net settlement with debt forgiveness in times of crisis. Major implications of the model include the superiority of net settlement to gross settlement, the instability of both gross and strict net settlement, and the optimality and stability of net settlement with debt forgiveness. It is shown that debt forgiveness -reducing the obligations of those who repay debt when others are defaulting- is a way to eliminate the strategic complementarity underlying the potential instability of the payments system.

Kiyotaki and Moore (1997) studied strategic complementarity in interrelated local credit markets with no central clearing market. Camera and Li (2008) studies similar strategic complementarity and multiplicity of equilibria in intermediated credit markets, but again without our emphasis on a central payments system⁴³. Even closer to our payments aims is Kahn, McAndrews, and Roberds (2003). Our work differs in its modeling of fiat money as the payments instrument⁴⁴, its proposal of net settlement with debt forgiveness, which works without collateral and is optimal when defaults occur, and its study of local stability of equilibria.

The Payment System in Practice

Figure 1 describes how a payment order is processed, and then cleared and settled in the absence of DVP. The issuer holds a monetary obligation (IOU payable) to be paid. She then sends her order for this obligation to be paid, which is processed by her own bank and, thus, through the central clearinghouse. The clearing process starts after the payment order is sent to the clearing house, and most generally follows three steps: transmission, reconciliations of the records with the payment order, and confirmation. Immediately after, the settlement process starts, involving generally transfers of funds or transfers of financial instruments. Finally, after both clearing and settlement, the obligation is discharged.

The alternative rules for the settlement of debt together with its finality play a key role in the determination of the overall functioning of the different Payment Systems. With respect to the rules of settlement, the three that are most commonly used today are Gross Settlement (GS), Net Settlement (NS) and Hybrid rules that combine both Gross and Net settlement rules. Gross rules settle obligations individually, while Net rules settle obligations on a net basis (it could be bilateral netting, but the most commonly used is multilateral netting.) With respect to Settlement Finality, Figure 2 shows the most common schemes.

In practice, there are many combinations of settlement and finality. In Table 1 you can appreciate the different systems, both privately-owned and Central-Bank-owned in all the countries that are members of the Committee on Payment and Settlement Systems (CPSS) at the Bank for International Settlements (BIS). The most common combination of rules and finality in the CPSS countries seems to be Real-Time Gross Settlement (RTGS), with 17 systems in the sample (20 for all GS.) All net settlement systems together add up to 13, while there are 4 systems with hybrid rules, including CHIPS among them. Thus, the predominance of Gross Settlement systems in practice is evident. However, it is worth pointing out that, as for the daily distribution of payments of most RTGS systems, and Fedwire in particular, most transactions take place in what is called the peak hour (about 4:30 pm)⁴⁵. So, even though Fedwire's and other GS systems' finality is supposed to be, technically, in real time and with DVP, in practice most of their transactions seem to be very close to the end of the day, both in volume and in value, making it somehow more comparable with most Net

⁴³ In their search model, fiat money and credit are alternative means of purchasing goods and debt is not settled using fiat money. Despite the models' differences in form, the models offer similar implications about the multiplicity of credit market equilibria.

⁴⁴ The modeling of fiat money as the payments instrument will be needed for any extensions to international payments systems, as in Hernandez-Verme (2004) and Fujiki (2003).

⁴⁵ See McAndrews and Rajan (2000) for more details.

Settlement and Hybrid systems. Under this consideration, the potential advantages of Net Settlement over Gross Settlement seem to play a more important role than one would have otherwise expected.

The Environment

Consider a closed, endowment economy. In each period a constant number of two-period-lived households are born. There is a generation of initial old endowed with a constant stock of M units of fiat money.

There are I outer islands. A continuum of households with unit mass populates each outer island. In addition, there are I different endowment-goods, each good being island-specific. Goods are not storable neither can they be produced. There exist no means of enforcing contracts in the outer islands.

There is a Central Island where the civil and monetary authority is located together with a central clearinghouse. Although contracts may be written anywhere, they can only be enforced only within the Central Island and through the clearinghouse.

Endowments and Preferences

Travel and endowments are built on Freeman and Tabellini (1998). Each young household born in island i , for $i=1, 2, 3, \dots, I$, is endowed with w units of the island- i -specific good. Old households have no endowment of goods.

A household j born in island i derives utility from consuming goods both when young and when old. Households are ex-ante identical within an island and across islands, in the sense that they have the same utility function: $u(c_1^j) + v(c_2^j) + \Gamma^j$, with $u'' < 0 < u'$ and $v'' < 0 < v'$, where both $u(\cdot)$ and $v(\cdot)$ satisfy the Inada conditions. The variable c_1^j denotes the consumption of household j when young, and c_2^j denotes its consumption when old. All the households in this economy face a symmetric problem. The good with which each household is endowed is not the good the household wants to consume: young households born in island i travel to and wish to consume only the good specific to island $i+1$; old households born in island i travel to and wish to consume only the good specific to island $i+I/2$ (modulo I).

Each period has two parts. During the first part of each period, intra-generational travel takes place: young households meet with neighbouring young households in the outer islands, while old households meet with other old households in the Central Island. During the second part of each period, the old travel to a distant outer island. Table 2 describes the structure of the trade patterns.

The variable Γ^j represents a nonpecuniary utility derived by old households, the value of which depends on whether the household visits the Central Island. By nonpecuniary we mean a utility not derived from the return from the assets held by a household. Without loss of generality, we set $\Gamma^j = \gamma^j$ if household j travels to the Central Island and 0 if it does not. By setting the utility of not going to the Central Island to 0, γ^j represents net locational utility, the net nonpecuniary benefit of living where contracts can be enforced (“the Pale”)⁴⁶. We think of γ^j as including punishments (if $\gamma^j < 0$) or rewards (if $\gamma^j > 0$) of being under the law, both incidental (e.g. the ability to visit nearby family) and man-made (e.g. criminal prosecution).

⁴⁶ We could alternatively measure γ in terms of goods. In this case the utility cost of a locational decision would vary with equilibrium prices affecting the marginal utility of consumption, making the model less tractable without altering the main implications. A locational goods cost may nevertheless be useful in the analysis of collateral requirements for clearinghouse payment system participants.

All households face the same distribution of locational utility, the realization of which is household-specific, and of any sign: $\gamma^j \in [\underline{\gamma}, \bar{\gamma}]$ is a stationary random variable, i.i.d. across both households and islands, with a p.d.f equal to $f(\gamma^j)$, where $\bar{\gamma} \geq 0$ always. The household learns γ^j only at the beginning of its last period of life. Notice that by allowing the net benefit to be household-specific, we allow households to be different ex-post, but we do not require it.

Those for any reason wary of the assumption of locational utility should note that absence of locational utility, $\gamma^{i,j} = 0$ always, is just one particular case where households are not only ex ante identical (they face a symmetric problem) but also ex post identical (they obtain the same amount of utility, but from different goods). It will become clear, once we discuss equilibria, that this case shares most of the equilibrium implications of the general model.

The Planner's Problem

Let \tilde{c}_2 denote the consumption of a household who does not to travel to the Central Island, and \hat{c}_2 be the consumption of an old household who travels to the Central Island. A benevolent planner will choose c_1 , \tilde{c}_2 , \hat{c}_2 and γ^* in order to maximize the expected utility of a typical household:

$$u(c_1) + \int_{\underline{\gamma}}^{\gamma^*} v(\tilde{c}_2) \cdot f(\gamma^j) \cdot d\gamma^j + \int_{\gamma^*}^{\bar{\gamma}} v(\hat{c}_2) \cdot f(\gamma^j) \cdot d\gamma^j + \int_{\gamma^*}^{\bar{\gamma}} \gamma^j \cdot f(\gamma^j) \cdot d\gamma^j, \quad (1)$$

restricted by the availability of resources in the economy:

$$w \geq c_1 + \int_{\underline{\gamma}}^{\gamma^*} \tilde{c}_2 \cdot f(\gamma^j) \cdot d\gamma^j + \int_{\gamma^*}^{\bar{\gamma}} \hat{c}_2 \cdot f(\gamma^j) \cdot d\gamma^j, \quad (2)$$

and by

$$\underline{\gamma} \leq \gamma^* \leq \bar{\gamma}. \quad (3)$$

Accordingly, three conditions must hold in a Social Optimum⁴⁷. The first condition, given by $\tilde{c}_2 = \hat{c}_2 \equiv c_2$,

states that old households consume equal amounts whether they travel to the Central Island or not. The second condition, given by

$$\frac{u'(c_1)}{v'(c_2)} = 1 \quad (5)$$

says that this allocation is not only optimal but it satisfies the Golden Rule (it maximizes utility over stationary allocations). Finally, the third condition for a social optimum is $\gamma^* \geq 0$, where

$$\gamma^* = 0, \text{ if } \underline{\gamma} < 0, \quad (6a)$$

$$\gamma^* = \underline{\gamma} > 0, \text{ if } \underline{\gamma} \geq 0. \quad (6b)$$

⁴⁷ Notice that, given the general form of preferences that we use in our model, this need not be the only Pareto Optimal allocation. However, this allocation constitutes a useful departing point for comparing equilibria under alternative rules for the settlement of debt.

Condition (6a) describes the unique socially optimal cut-off value when travel to the Central Island is costly for some ($\underline{\gamma} < 0$) and (6b) when travel to the Central Island is costly for none ($\underline{\gamma} \geq 0$). Let $\pi \equiv \int_{\underline{\gamma}^*}^{\bar{\gamma}} f(\gamma^j) \cdot d\gamma^j$ denote the fraction of old households who travel to the Central Island. Interestingly, when some households are hurt (in non pecuniary ways) by travel to the Central Island ($\underline{\gamma} < 0$) it is best not only for the household but also for the economy as a whole if this household does not travel to the Central Island and, thus $\pi < 1$. When instead all enjoy travel to the Central Island ($\underline{\gamma} \geq 0$), then optimality involves no avoidance of the Central Island because only “good things” can happen to a household there and $\pi = 1$. We formalize these results in the following propositions.

Proposition 1: When travel to the Central Island is costly for some ($\underline{\gamma} < 0$), the social optimum allocation requires that these old households not travel to the Central Island ($\gamma^* = 0$).

Proof: When ($\underline{\gamma} < 0$), $\gamma^* = 0 < \bar{\gamma}$ is an interior solution. Thus, $\pi \equiv \int_{\underline{\gamma}^*}^{\bar{\gamma}} f(\gamma^j) \cdot d\gamma^j < 1$ and some households do not travel to the Central Island. *Q.E.D.*

Proposition 2: When travel to the Central Island is costly for none ($\underline{\gamma} \geq 0$), the social optimum allocation requires all old households to travel to the Central Island $\gamma^* = \underline{\gamma}$.

Proof: When ($\underline{\gamma} \geq 0$), $\gamma^* = \underline{\gamma}$ is a corner solution. Thus, $\pi \equiv \int_{\underline{\gamma}^*}^{\bar{\gamma}} f(\gamma^j) d\gamma^j = 1$ and all old households travel to the Central Island. *Q.E.D.*

The social optimal allocation described by (4), (5), and (6a, b) is unique.

Trade and Travel Patterns

a) Young households, first part of the period

During the first part of the period, each household splits into two parts: a buyer and a seller. The young buyer born in island i travels to island $i+1$, to purchase good $i+1$. The young seller born in island i remains in island i , waiting for buyers from island $i-1$, in order to sell part of the endowment good to them. At this point, the young buyers from island i have nothing of value to offer to sellers born in island $i+1$ in exchange for their good. Thus, the buyer from island i may issue debt (an IOU) to the seller in island $i+1$ in exchange for good i . We assume that the total debt of each household can be observed in the outer islands, so that in equilibrium young households cannot borrow infinite, unrepayable amounts⁴⁸ and cannot exhaust their endowments by issuing IOUs. This promise, the IOU (i.e. the IOU payable,) must be repaid next period on the Central Island through the central clearinghouse, since this is the only time when people will get together. As we will see, only fiat money is useful to old agents in making purchases in the outer islands. Therefore, old agents will require that debt be repaid using fiat money. Let r denote the gross real interest rate promised on the debt issued. Then sellers accept the IOUs (IOUs receivable.)

Once these transactions take place, the young buyers go back home with the good they purchased. At this stage, the buyer and seller of each household are reunited and they consume this good.

⁴⁸ We abstract from a moral hazard problem in borrowing, so that that we can focus on the incentives to repay debt.

b) Young and old households, second part of the period

During the second part of the period, the young households from island i sell the remainder of their endowment good to old households from island $(i-I/2)$ in exchange for fiat money. At this point, the young households accept only fiat money because next period they will need it either to settle debt or to purchase goods. The old households consume the good they purchased.

c) Old households, first part of the period

At the beginning of the period, the old household j observes the realization of the random variable γ^j , which is private information. Notice that ex-ante preferences are identical, but they are different ex-post. We now define γ^* as the cut-off value for a typical old household, such that $\gamma^* \in [\underline{\gamma}, \bar{\gamma}]$ holds. When $\gamma^j < \gamma^*$, then the old household j chooses not to travel to the Central Island, and when $\gamma^j \geq \gamma^*$ the old household j chooses to travel to the Central Island.

If an old household chooses to go to the Central Island during the first part of the period, it carries fiat money from the previous period. In addition, this household must repay its debt, even though only other households who owe him and travel to the Central Island pay him back. Debt is settled by third parties in the Central Island. Finally, this old household gets the utility γ^j and consumes \hat{c}_2 goods during the second part of the period.

If an old household chooses not to go to the Central Island during the first part of the period, it still carries fiat money from the previous period. However, this household does not repay its debt nor does get paid for the debt it accepted the previous period. Notice that the identity of a household is unknown in the outer islands, and also that contracts are not enforceable there either. This household consumes \tilde{c}_2 goods during the second part of the period by exchanging it for fiat money.

As before, we define π to be the fraction of old households traveling to the Central Island.

Throughout the paper, we focus on stationary allocations.

Alternative Rules of Settlement and Equilibria**A Net Settlement Rule with Debt Forgiveness**

Under a net settlement rule with debt forgiveness, any loss from a default is shared by all participants in the payments system. This means that if $\pi \in [0,1]$ is the fraction of old households traveling to the Central Island, an old household traveling to Central Island would have to pay only a fraction π of its gross debt. In addition, IOUs receivable can also be used as means for repaying IOUs payable. As a result, the old household's holdings of fiat money would need to be enough to cover only its net debt. A real life example of such a loss-sharing arrangement is the Lamfalussy rule⁴⁹.

1.1.1.1.a) The Household's problem

Let b_t denote the nominal value of debt issued by the household (IOUs payable,) s_t the nominal value of debt accepted by the household (IOUs receivable,) m_t the household's nominal holdings of fiat money, and p_t the price level at time t . Let also R be the effective (net of defaults) gross real interest rate paid on the household's loan. Then, if the subscript F refers to net settlement

⁴⁹ Notice, however, that the Lamfalussy rule has an additional requirement to post collateral.

with debt forgiveness, a typical household will choose $\left(\frac{b_t}{p_t}\right)_F$, $\left(\frac{s_t}{p_t}\right)_F$, $\left(\frac{m_t}{p_t}\right)_F$ and γ_F^* in order to maximize its lifetime utility (1), subject to the following budget constraints:

$$c_{1,F} = \left(\frac{b_t}{p_t}\right)_F, \quad (7)$$

$$\left(\frac{s_t}{p_t}\right)_F + \left(\frac{m_t}{p_t}\right)_F = w, \quad (8)$$

$$\tilde{c}_{2,F} = \left(\frac{m_t}{p_t}\right)_F, \quad (9)$$

$$\hat{c}_{2,F} = R_F \cdot \left(\frac{s_t}{p_t}\right)_F - \pi_F \cdot r_F \cdot \left(\frac{b_t}{p_t}\right)_F + \left(\frac{m_t}{p_t}\right)_F, \quad (10)$$

and

$$\left(\frac{b_t}{p_t}\right)_F \geq 0, \quad \left(\frac{s_t}{p_t}\right)_F \geq 0, \quad \left(\frac{m_t}{p_t}\right)_F \geq 0, \quad \underline{\gamma} \leq \gamma_F^* \leq \bar{\gamma}. \quad (11)$$

Equation (7) states that consumption when young is purchased using debt. Equation (8) states that the young household's endowment good can either be sold to other young households in exchange for debt or sold to old households in exchange for fiat money. Equation (9) states that when an old household chooses not to travel to the Central Island, its consumption is purchased only with fiat money balances. Notice that the gross promised return from the household's debt is given by $r_F \cdot \left(\frac{b_t}{p_t}\right)_F$ and π_F is the fraction of old households who are on the Central Island. Under this rule of settlement, the household must pay only the fraction π_F of its IOUs payable, and the household's net debt is equal to $R_F \cdot \left(\frac{s_t}{p_t}\right)_F - \pi_F \cdot r_F \cdot \left(\frac{b_t}{p_t}\right)_F$. Thus, equation (10) indicates that when an old household chooses to travel to the Central Island, its consumption is paid with net debt and fiat money. Equation (11) describes the range of possible values for each one of the choice variables.

The first order conditions determining the household's choice of debt, money and default are given by

$$u'(c_{1,F}) = \pi_F^2 \cdot r_F \cdot v'(\hat{c}_{2,F}) \quad (12)$$

$$(R_F - 1) \cdot \pi_F \cdot v'(\hat{c}_{2,F}) = (1 - \pi_F) \cdot v'(\tilde{c}_{2,F}) \quad (13)$$

$$\gamma_F^* \geq v(\tilde{c}_{2,F}) - v(\hat{c}_{2,F}) \quad (14)$$

Equation (12) describes the household's choice between consumption purchased with debt $(c_{1,F})$ and consumption purchased with fiat money and net debt $(\hat{c}_{2,F})$. Next, equation (13) describes the intra-temporal choice of the household when old: the trade-off between consuming when traveling to the Central Island and consuming when not traveling to the Central Island. Finally, equation (14) describes the household's choice of when to default.

b) Market Clearing

The market for loans clears when total borrowing equals total lending:

$$\left(\frac{b_t}{p_t} \right)_F = \left(\frac{s_t}{p_t} \right)_F. \quad (15)$$

Also, from feasibility of the settlement of debt in the Central Island we obtain

$$R_F = \pi_F \cdot r_F \quad (16)$$

That is, the effective interest rate on loans equals the promised interest rate on loans adjusted by the fraction of old households who travel to the Central Island.

c) Equilibrium and Optimality under a Net Settlement Rule with Debt Forgiveness

Under a net settlement rule with debt forgiveness the equilibrium conditions satisfy the optimality conditions (4), (5) and (6a) or (6b) hold. This can be shown very easily, and we proceed in two steps. First, by using the aggregate consistency condition (16) in the budget constraints (9) and (10), we obtain the following equilibrium condition

$$\tilde{c}_{2,F} = \hat{c}_{2,F} = \left(\frac{m_t}{p_t} \right)_F. \quad (17)$$

Combining the equilibrium condition (17) with the first order condition (14) we obtain

$$\gamma_F^* \geq 0, \quad (18)$$

implying the following equilibrium condition

$$\gamma_F^* = 0, \quad \text{if } \underline{\gamma} < 0 \quad (18a)$$

$$\gamma_F^* = \underline{\gamma} > 0, \quad \text{if } \underline{\gamma} \geq 0 \quad (18b)$$

Thus, from the equilibrium conditions (17) and (18a) or (18b) it follows directly that the optimality conditions (4) and (6a) or (6b) hold in equilibrium.

As a second step, we proceed to show that the optimality condition (5) holds in equilibrium. By combining the equilibrium condition (17) with the intra-temporal first order condition (13), the following condition can be easily derived

$$(\pi_F \cdot r_F - 1) = \frac{(1 - \pi_F)}{\pi_F}. \quad (19)$$

Notice that two cases may arise, depending on whether or not travel to the Central Island is costly for some. We describe both cases below.

c.1) Case 1: travel to the Central Island is costly for some, $\underline{\gamma} < 0$. The equilibrium condition (18a) implies not only that π_F is unique but also that $\pi_F < 1$, i.e.: a positive fraction of the population defaults. In particular, it follows directly from (19) that $\pi_F \cdot r_F = \frac{1}{\pi_F} > 1$, implying that

the equilibrium $r_F = \frac{1}{\pi_F} > 1$ is unique (given that the equilibrium π_F is unique). By combining the inter-temporal first order condition (12) with the equilibrium conditions (17), (18a) and (19), it is fairly easy to show that the following condition holds in equilibrium

$$\frac{u'(c_{1,F})}{v'(\hat{c}_{2,F})} = \pi_F^2 \cdot r_F = 1. \quad (20)$$

The inter-temporal equilibrium condition (20) clearly implies that the inter-temporal optimality condition (5) is satisfied. Thus, (4), (5) and (6a) are satisfied in equilibrium when traveling to the Central Island is Costly for some, and this equilibrium is unique, stable and optimal.

c.2) Case 2: travel to the Central Island is costly for none, $\underline{\gamma} \geq 0$. The equilibrium condition (18b) implies that $\pi_F = 1$. Thus, this is a unique equilibrium that displays universal repayment. In addition, it follows from (19) that $r_F = 1$ in equilibrium. In addition, the combination of the inter-temporal first order condition (12) and the equilibrium conditions (17), (18b) and (19), yields the equilibrium condition (20), which holds as well in this case. The latter implies that the inter-temporal optimality condition (5) is satisfied. Therefore, (4), (5) and (6b) are satisfied in equilibrium when traveling to the Central Island is costly for none, and this equilibrium is unique, stable and optimal.

Summarizing, the equilibrium resulting from a rule of net settlement with debt forgiveness is always unique, stable and optimal.

Strict Net Settlement

Under this system, the loss-sharing rule in place is settlement unwinding: if a bank defaults, its transactions are removed from that day's transactions, net positions are recalculated for the remaining banks, and the settlement of recalculated positions proceeds as in normal settlement⁵⁰. Under a strict settlement rule, an old household traveling to the Central Island would have to pay all of its gross debt. But the IOUs receivable are accepted as payment of IOUs payable. Thus, the old households need to bring enough real money balances to pay for their net debt. In this case, the subscript N refers to the Strict Net Settlement rule, but we maintain the general notation used before.

1.1.1.2.a) The household's problem

Under this rule of settlement, a typical household chooses $\left(\frac{b_t}{p_t}\right)_N$, $\left(\frac{s_t}{p_t}\right)_N$, $\left(\frac{m_t}{p_t}\right)_N$ and γ_N^*

in order to maximize its expected lifetime utility (1), subject to the budget constraints (7), (8), (9), (11) and:

$$\hat{c}_{2,N} = R_N \cdot \left(\frac{s_t}{p_t}\right)_N - r_N \cdot \left(\frac{b_t}{p_t}\right)_N + \left(\frac{m_t}{p_t}\right)_N. \quad (21)$$

Notice that a household's net debt is given by $R_N \cdot \left(\frac{s_t}{p_t}\right)_N - r_N \cdot \left(\frac{b_t}{p_t}\right)_N$ under this rule of settlement. The first order conditions for this problem are given by

$$u' \left[\left(\frac{b_t}{p_t}\right)_N \right] = \pi_N \cdot r_N \cdot v' \left[R_N \cdot \left(\frac{s_t}{p_t}\right)_N - r_N \cdot \left(\frac{b_t}{p_t}\right)_N + \left(\frac{m_t}{p_t}\right)_N \right], \quad (22)$$

$$(R_N - 1) \cdot \pi_N \cdot v' \left[R_N \cdot \left(\frac{s_t}{p_t}\right)_N - r_N \cdot \left(\frac{b_t}{p_t}\right)_N + \left(\frac{m_t}{p_t}\right)_N \right] = (1 - \pi_N) \cdot v' \left[\left(\frac{m_t}{p_t}\right)_N \right], \quad (23)$$

$$\gamma_N^* \geq v \left[\left(\frac{m_t}{p_t}\right)_N \right] - v \left[R_N \cdot \left(\frac{s_t}{p_t}\right)_N - r_N \cdot \left(\frac{b_t}{p_t}\right)_N + \left(\frac{m_t}{p_t}\right)_N \right]. \quad (24)$$

Equation (22) describes the household's inter-temporal choice of consumption, which is also its choice between goods purchased with debt ($c_{1,N}$) and goods purchased with fiat money if it travels

⁵⁰ See BIS (2003) and Kahn, McAndrews and Roberds (2003.)

to the Central Island ($\hat{c}_{2,N}$). Next, equation (23) describes the household's intra-temporal choice: how much would the household consume if it chose to travel to the Central Island ($\hat{c}_{2,N}$) versus how much it would consume if it chose not to travel to the Central Island ($\tilde{c}_{2,N}$). Finally, (24) describes the household's choice of its cut-off value, γ_N^* .

Notice that the market clearing conditions (15) and (16) also hold under this rule.

b) Equilibria and Optimality under a Strict Net Settlement Rule

We combine the aggregate consistency conditions (15) and (16) with the first order conditions (22), (23) and (24). We can then show that equilibria under a strict net settlement rule are described

by a system of three nonlinear equations in $\left(\frac{s_t}{p_t}\right)_N$, r_N , and γ_N^* , as follows:

$$u' \left[\left(\frac{s_t}{p_t} \right)_N \right] = \pi_N \cdot r_N \cdot v' \left[w + (\pi_N \cdot r_N - r_N - 1) \cdot \left(\frac{s_t}{p_t} \right)_N \right], \quad (25)$$

$$(\pi_N \cdot r_N - 1) \cdot \pi_N \cdot v' \left[w + (\pi_N \cdot r_N - r_N - 1) \cdot \left(\frac{s_t}{p_t} \right)_N \right] = (1 - \pi_N) \cdot v' \left[w - \left(\frac{s_t}{p_t} \right)_N \right], \quad (26)$$

$$\gamma_N^* \geq v \left[w - \left(\frac{s_t}{p_t} \right)_N \right] - v \left[w + (\pi_N \cdot r_N - r_N - 1) \cdot \left(\frac{s_t}{p_t} \right)_N \right]. \quad (27)$$

It is obvious that equilibria under a Strict Net Settlement rule without universal repayment must have a net positive nominal interest rate.

Lemma 1: the expected return to debt, $\pi_N \cdot r_N$, exceeds the return to fiat money, 1, in all equilibria with a strict net settlement rule displaying default ($\pi_N < 1$).

Proof: Any equilibrium with $\pi_N < 1$ and $\pi_N \cdot r_N < 1$ violates the equilibrium condition (26). Thus, it must be the case that $\pi_N \cdot r_N > 1$ in any equilibrium that features $\pi_N < 1$. *Q.E.D.*

b.1) Multiplicity of Equilibria. Under a strict net settlement rule, strategic complementarities are present in the following sense: if a household believes that few other households will show up at the Central Island, this household may not want to show up either. The more other old households default, the more a given household would want to default. The reason is that under a strict net settlement rule, the default of other households does reduce what a given household receives in the Central Island (IOUs receivable) but it does not reduce what the household owes (IOUs payable.) Thus, not only does a strict net settlement rule readily allow multiple, Pareto ranked steady state equilibria, but also, some of these equilibria may be locally unstable.

b.2) Equilibria in the absence of locational utility. The inherent instability of equilibria under strict net settlement may be illuminated with a look at the special case of the absence of any locational utility, $\underline{\gamma} = \bar{\gamma} = 0$. A household's choice of a cut-off locational decision γ_N^* implies a specific probability π_N that it will go to the Central Island. In Figure 3, $\pi_N(j)$ denotes this probability as a result of household j 's strategy, while $\pi_N(-j)$ denotes this probability as a result of the strategies of the other households. In the absence of any locational utility there are two equilibria: one in which all debt is repaid ($\pi_N = 1$) and another with universal default ($\pi_N = 0$), as illustrated in Figure 3.

However, the equilibrium in which all debt is repaid is unstable. If any single household will fail to pay its debt, the value of IOUs receivable falls below the value of IOUs payable for the other households. In the absence of any nonpecuniary returns to travel to the Central Island, all other households will now also choose to default.

b.3) *Equilibrium when travel to the Central Island is always beneficial.* Consider next equilibria when travel to the Central Island is always beneficial: $\underline{\gamma} > 0$. The universal desirability of travel to the Central Island now makes the equilibrium with a high π_N stable. Figure 4a illustrates this possibility. There is a stationary equilibrium in a situation where $\pi_N(j) = \pi_N(-j)$. For illustration purposes, Figure 4a depicts an example where households have a log linear utility function, $\underline{\gamma} \geq 0$ and $\bar{\gamma} > 0$. Notice that there are three steady state equilibria. In the first equilibrium, $\pi_N = 0$ and all the households default; this equilibrium is locally stable. In the second equilibrium (an interior equilibrium), $0 < \pi_N < 1$ and there is some default; this equilibrium is locally unstable. Finally, in the third equilibrium, $\pi_N = 1$ and there is no default. This equilibrium is locally stable: it can tolerate small departures from the strategy of never defaulting because travel to the Central Island has nonpecuniary benefits.

Proposition 3: When $\underline{\gamma} > 0$, one strict net settlement equilibrium features universal repayment ($\pi_N = 1$), and this equilibrium is optimal.

Proof: If $\underline{\gamma} > 0$, optimality involves $\gamma_N^* = \underline{\gamma}$ and $\pi_N = 1$. When $\pi_N = 1$, using the budget constraints (9) and (18), we obtain that the optimality condition (4) holds in equilibrium. In addition, given that $\hat{c}_{2,N} = \tilde{c}_{2,N}$ and that $\pi_N = 1$, the equilibrium condition (26) yields $r_N = 1$. As a consequence, the optimality condition (5) also holds in equilibrium. Finally, (6b) can be easily obtained as one possible outcome from the equilibrium condition (27). Thus, one strict net settlement equilibrium features $\gamma_N^* = \underline{\gamma}$, and this equilibrium is optimal and locally stable. *Q.E.D.*

However, equilibria under a strict net settlement rule are typically not unique. Thus, Proposition 3 only states that the “best” equilibrium under a strict net settlement rule, the one with no default, is optimal. The remainder of the equilibria under a strict net settlement rule display $\gamma_N^* > \underline{\gamma}$ and a strictly positive rate of default which is obviously larger than the social optimum. Therefore, the remaining equilibria are Pareto dominated by the best equilibrium. Following this principle, and due to the presence of strategic complementarities under a strict net settlement rule, it is possible to establish a Pareto ranking of these equilibria according to their rate of default: equilibria with a higher rate of default are Pareto dominated by equilibria with a lower rate of default. Therefore, when $\underline{\gamma} > 0$ so that default is always undesirable, there is an equilibrium from the strict net settlement rule that is as optimal as net settlement with debt forgiveness. Net settlement with debt forgiveness, however, avoids a multiplicity of equilibria, while strict net settlement does not.

b.4) *Equilibrium when travel to the Central Island is costly to some.* Consider next equilibria when travel to the Central Island is costly for some ($\underline{\gamma} < 0$), but beneficial for a positive fraction of households.

Proposition 4: No strict net settlement equilibria are optimal when $\underline{\gamma} < 0$.

Proof: Suppose $\underline{\gamma} < 0$, so that optimality requires $\gamma_N^* = 0$. Notice that $\pi_N < 1$ for any γ_N^* such that $\underline{\gamma} < \gamma_N^* \leq 0$. Obviously, optimality under these circumstances involves some default. Using the budget constraints (9) and (18), we obtain

$$\tilde{c}_{2,N} = \left(\frac{m_t}{p_t} \right)_N > \hat{c}_{2,N} = (\pi_N - 1) \cdot r_N \cdot \left(\frac{s_t}{p_t} \right)_N + \left(\frac{m_t}{p_t} \right)_N. \quad (28)$$

Evaluating the equilibrium condition (27) using (28), we obtain

$$\gamma_N^* = v(\tilde{c}_{2,N}) - v(\hat{c}_{2,N}) > 0. \quad (29)$$

Thus, $\gamma_N^* = 0$, the optimal solution when $\underline{\gamma} < 0$, is not an equilibrium. Also, any allocation with $\underline{\gamma} < \gamma_N^* < 0$ is not an equilibrium under a strict net settlement rule. Instead, all equilibria under a strict net settlement rule display $\gamma_N^* > 0$ and the rate of default observed in equilibrium is larger than at the social optimum. *Q.E.D.*

Figure 4b illustrates the case of a log-linear utility where $\underline{\gamma} < 0$.

Figure 5a illustrates the nonoptimality of even the best of multiple equilibria when households have a Constant Relative Risk Aversion (CRRA) utility function and traveling to the Central Island is costly for some, but beneficial for a positive fraction of households.

It may also be the case that the costs of travel to the Central Island are sufficiently high that no one wishes to go there –even those with nonpecuniary benefits find these outweighed by the pecuniary losses caused by the default of others. Figure 5b illustrates this possibility also when households have a Constant Relative Risk Aversion utility function, so that we can compare with Figure 5a. In this case there is a unique equilibrium. In this equilibrium, which is stable, all households default. This equilibrium with $\pi_N = 0$ is not optimal, optimality requiring that $\gamma_N^* = 0$ and thus $0 < \pi_N < 1$.

Strict Gross Settlement

Under a (strict) gross settlement rule, IOUs receivable cannot be used to pay IOUs payable, and there is unwinding. As a result, old households need to carry enough fiat money to pay for their gross debt. As before, the household's gross debt is given by $r_G \cdot \left(\frac{b_t}{p_t} \right)_G$, where the subscript G indicates a gross settlement rule.

a) The household's problem

Under a gross settlement rule, a typical household chooses $\left(\frac{b_t}{p_t} \right)_G$, $\left(\frac{s_t}{p_t} \right)_G$, $\left(\frac{m_t}{p_t} \right)_G$ and γ_G^* in order to maximize its lifetime utility (1), subject to the budget constraints (7), (8), (9), (11), (18) and the following additional constraint:

$$\left(\frac{m_t}{p_t} \right)_G \geq r_G \cdot \left(\frac{b_t}{p_t} \right)_G. \quad (30)$$

The inequality (30) reflects that, under a gross settlement rule, each household must carry enough real money balances to pay its gross debt.

Let μ be the Lagrange multiplier associated with constraint (30). Then, the first order conditions for this problem are given by

$$u' \left[\left(\frac{b_t}{p_t} \right)_G \right] - \pi_G \cdot r_G v' \left[R_G \cdot \left(\frac{s_t}{p_t} \right)_G - r_G \cdot \left(\frac{b_t}{p_t} \right)_G + \left(\frac{m_t}{p_t} \right)_G \right] = \mu \cdot r_G, \quad (31)$$

$$(1 - \pi_G) \cdot v' \left[\left(\frac{m_t}{p_t} \right)_G \right] + \mu = \pi_G \cdot (R_G - 1) \cdot v' \left[R_G \cdot \left(\frac{s_t}{p_t} \right)_G - r_G \cdot \left(\frac{b_t}{p_t} \right)_G + \left(\frac{m_t}{p_t} \right)_G \right], \quad (32)$$

$$\gamma_G^* \geq v \left[\left(\frac{m_t}{p_t} \right)_G \right] - v \left[R_G \cdot \left(\frac{s_t}{p_t} \right)_G - r_G \cdot \left(\frac{b_t}{p_t} \right)_G + \left(\frac{m_t}{p_t} \right)_G \right], \quad (33)$$

and (30). The market clearing conditions (15) and (16) also hold.

b) Equilibria and Optimality under Strict Gross Settlement

After combining the aggregate consistency conditions (15) and (16) with the first order conditions (31), (32) and (33), we can show that equilibria are described by the following system of

three nonlinear equations in $\left(\frac{s_t}{p_t} \right)_G$, r_G , γ_G^* and μ :

$$u' \left[\left(\frac{s_t}{p_t} \right)_G \right] - \pi_G \cdot r_G \cdot v' \left[w + (\pi_G \cdot r_G - r_G - 1) \cdot \left(\frac{s_t}{p_t} \right)_G \right] = \mu \cdot r_G, \quad (34)$$

$$(1 - \pi_G) \cdot v' \left[w - \left(\frac{s_t}{p_t} \right)_G \right] + \mu = \pi_G \cdot (\pi_G \cdot r_G - 1) \cdot v' \left[w + (\pi_G \cdot r_G - r_G - 1) \cdot \left(\frac{s_t}{p_t} \right)_G \right], \quad (35)$$

$$\gamma_G^* \geq v \left[w - \left(\frac{s_t}{p_t} \right)_G \right] - v \left[w + (\pi_G \cdot r_G - r_G - 1) \cdot \left(\frac{s_t}{p_t} \right)_G \right], \quad (36)$$

$$\text{If } w > (r_G + 1) \cdot \left(\frac{s_t}{p_t} \right)_G, \text{ then } \mu = 0, \quad (37a)$$

$$\text{If } w = (r_G + 1) \cdot \left(\frac{s_t}{p_t} \right)_G, \text{ then } \mu > 0. \quad (37b)$$

Notice that equilibria under a gross settlement rule constitute (weakly) constrained strict net settlement equilibria. We then give the following two definitions.

Definition 1: An **Unconstrained Gross Settlement Equilibrium** is defined as an equilibrium resulting from a gross settlement rule where (37a) holds, and the additional constraint on real money balances does not bind.

Definition 2: A **Constrained Gross Settlement Equilibrium** is defined as an equilibrium resulting from a gross settlement rule where (37b) holds, and the additional constraint on real money balances does bind.

When (37a) holds, the gross settlement equilibrium conditions (34) – (36) are identical to those of strict net settlement, (25) – (27), leading to Proposition 5.

Proposition 5: Equilibrium allocations resulting from an unconstrained gross settlement rule are identical to those resulting from a strict net settlement rule.

When (37b) holds, gross settlement equilibria are identical to strict net settlement equilibria but with one additional constraint to be satisfied. Thus constrained gross settlement equilibria offer less utility than its strict net settlement counterpart, leading to the following proposition⁵¹.

Proposition 6: For each constrained gross settlement equilibrium there is a Pareto superior equilibrium resulting from a strict net settlement rule.

Figure 6 illustrates one example this proposition. The proof can be found in the Appendix.

Also, the scope for multiple equilibria is preserved in the system both under unconstrained and constrained gross settlement. Gross settlement does not reduce the strategic complementarities that may lead to the breakdown of the payments system. Multiple equilibria occur under unconstrained gross settlement whenever they occur under strict net settlement, all being defined by the same conditions. By the continuity of equilibrium conditions, where multiple equilibria occur in strict net settlement, they occur in constrained gross settlement, at a minimum where the constraint does not strongly bind (values of μ close to 0).

Welfare Analysis

We now turn to compare the welfare of equilibria under the alternative settlement rules that we have discussed so far. As we see below, the welfare properties differ according to whether $\underline{\gamma} < 0$ or $\underline{\gamma} \geq 0$. The summary of our results is presented in Table 3.

It is obvious that the Social Planner's solution –and the equilibrium under net settlement with debt forgiveness, is Pareto optimal, and therefore it occupies the first place in our ranking. Additionally, when $\underline{\gamma} \geq 0$, the best equilibrium under strict net settlement, which displays universal repayment, is Pareto optimal as well.

Equilibria resulting from a strict net settlement rule –other than the best equilibrium when $\underline{\gamma} \geq 0$, are Pareto dominated by the equilibria under net settlement with debt forgiveness, thus occupying the second place in our ranking. We have also shown that equilibrium allocations that result from unconstrained gross settlement equilibria are identical to their counterpart under a strict net settlement rule and, thus, they yield the same welfare.

Finally, constrained gross settlement equilibria are Pareto dominated by unconstrained gross settlement equilibria, yielding lower welfare and therefore occupying the last place in our ranking.

A Collateral Requirement

We now introduce collateral into our model and examine the properties of equilibria under the three alternative settlement rules examined in this paper. Young households who borrow $\frac{b_t}{p_t}$ goods at t must put aside k_t units of fiat money. k_t is a nominal variable that is exogenously determined by the laws and rules governing the financial system. The collateral is set apart before the end-of period t , immediately after the old households exchange fiat money for part of the young households' endowment good. At this point, the collateral is shipped to the clearinghouse on the Central Island, where it is kept until $t+1$. Later, during the first part of the period $t+1$, the collateral will be divided equally among the old households who travel to the Central Island. We will now describe how the inclusion of collateral affects the results obtained under each of the three rules of settlement discussed in the previous section.

⁵¹ This utility loss when households are forced by gross settlement is fairly general and noted widely in the literature, including Angelini (1998) and Kahn and Roberds (2001).

A Collateral Requirement in a Net Settlement System with Debt Forgiveness: the Lamfalussy Rule.

The budget constraints (8) and (10) faced by households under a net settlement rule with debt forgiveness are replaced by the following equations, where the subscript *FC* indicates a net settlement rule with debt forgiveness and collateral:

$$w = \left(\frac{s_t}{p_t} \right)_{FC} + \left(\frac{m_t}{p_t} \right)_{FC} + \left(\frac{k_t}{p_t} \right), \quad (38)$$

$$\hat{c}_{2,FC} = R_{FC} \cdot \left(\frac{s_t}{p_t} \right)_{FC} - \pi_{FC} \cdot r_{FC} \cdot \left(\frac{b_t}{p_t} \right)_{FC} + \left(\frac{m_t}{p_t} \right)_{FC} + \left(\frac{1}{\pi_{FC}} \right) \cdot \frac{k_t}{p_t}. \quad (39)$$

Notice that (39) and feasibility rule out universal default ($\pi_{FC} = 0$) as a possible equilibrium. Moreover, feasibility will also rule out equilibria with values of π_{FC} that are close enough to zero. The uniqueness of the equilibrium under this settlement rule is preserved after the collateral requirement is introduced. However, the equilibrium is not Pareto optimal because collateral is costly. The equilibrium probability of default might be reduced or not with respect to the no collateral case depending on whether traveling to the Central Island is costly or not.

a) Equilibrium and Optimality when Travel to the Central Island is always beneficial ($\underline{\gamma} \geq 0$).

In this case, $\gamma_{FC}^* = \underline{\gamma}$, $\pi_{FC} = 1$, and there is no default in equilibrium. Thus, condition (6b) for optimality is satisfied. However, $\hat{c}_{2,FC} > \tilde{c}_{2,FC}$ and $\frac{u'(c_{1,FC})}{v'(\hat{c}_{2,FC})} > 1$ in equilibrium, and conditions

(4) and (5) for optimality are not satisfied. Thus the equilibrium displays the optimal probability of default –with universal repayment, but it is not Pareto optimal due to the costly collateral.

b) Equilibrium and Optimality when Travel to the Central Island is costly for some ($\underline{\gamma} < 0$).

In this case, $\underline{\gamma} < \gamma_{FC}^* < 0$, implying a lower fraction of the population defaulting in equilibrium compared to the Golden Rule allocation. However, in this case also $\hat{c}_{2,FC} > \tilde{c}_{2,FC}$ and $\frac{u'(c_{1,FC})}{v'(\hat{c}_{2,FC})} > 1$ in equilibrium, and conditions (4) and (5) for optimality are not satisfied as well. Thus,

this equilibrium is suboptimal: introducing collateral reduces default beyond the optimal level (the Golden Rule), but a collateral requirement is costly.

A Collateral Requirement in a Strict Net Settlement Rule

In the case of a strict net settlement rule, equations (8) and (21) are replaced by the following equations, where the subscript *NC* indicates a strict net settlement rule with collateral requirements

$$w = \left(\frac{s_t}{p_t} \right)_{NC} + \left(\frac{m_t}{p_t} \right)_{NC} + \left(\frac{k_t}{p_t} \right), \quad (40)$$

$$\hat{c}_{2,NC} = R_{NC} \cdot \left(\frac{s_t}{p_t} \right)_{NC} - r_{NC} \cdot \left(\frac{b_t}{p_t} \right)_{NC} + \left(\frac{m_t}{p_t} \right)_{NC} + \left(\frac{1}{\pi_{NC}} \right) \cdot \frac{k_t}{p_t}. \quad (41)$$

Notice that equation (41) and feasibility rule out universal default ($\pi_{NC} = 0$) as a possible equilibrium here as well, together with equilibria displaying values of π_{NC} that are close enough to zero.

The introduction of a collateral requirement in a strict net settlement rule reduces the scope for multiple equilibria generated by strategic complementarities. Moreover, the equilibria with higher probability of default disappear.

a) Equilibrium and Optimality when Travel to the Central Island is always beneficial ($\underline{\gamma} \geq 0$).

In Figure 7 we present the results from a numerical example using a log-linear utility function. This figure is comparable with Figure 4, where collateral was not required. We do observe that once the collateral requirement is introduced, the two equilibria with higher probability of default disappear. Moreover, the equilibrium is unique and globally stable, displaying $\gamma_{NC}^* = \underline{\gamma}$ and $\pi_{NC} = 1$, as in the universal repayment equilibrium with no collateral. However, this equilibrium is suboptimal, given that collateral is costly.

b) Equilibrium and Optimality when Travel to the Central Island is costly for some ($\underline{\gamma} \geq 0$)

With log-linear preferences in the absence of a collateral requirement there were typically two equilibria: one with $\pi = 0$ and $\pi = 1$; however, when the costs of travel to the Central Island were sufficiently high, the equilibrium with $\pi = 1$ disappeared, and there was only one equilibrium with universal default.

The introduction of a collateral requirement in a strict net settlement rule when travel to the Central Island is costly reduces the number of equilibria. In Figure 8a we present the results of numerical examples for the case when travel to the Central Island is costly for some but the cost is not sufficiently high. In this case, introducing collateral eliminates the equilibrium with universal default ($\pi = 0$), and the equilibrium with $\pi = 1$ remains the unique equilibrium. However, this equilibrium is suboptimal because of mainly two reasons: (i) zero default is not optimal in this when traveling to the Central Island is costly for some; and (ii) collateral is costly.

In Figure 8b we present the results of numerical examples for the case when the cost of travel to the Central Island is sufficiently high. In this case, after introducing collateral the number of equilibria is preserved: there is still a unique equilibrium. However, there is no universal default anymore: the fraction of the population who default in equilibrium is significantly lower, lower even than the optimal one. Thus, this equilibrium is suboptimal for the same reasons that we stated before: (i) zero default is not optimal when traveling to the Central Island is costly for some; and (ii) collateral is costly.

A Collateral Requirement with a Gross Settlement Rule

We have showed in Section 3.3 that Unconstrained Gross Settlement Equilibria are identical to their counterpart under a Strict Net Settlement rule. We can expect then that these unconstrained gross settlement equilibria will be affected in a similar way as strict net settlement equilibria when a collateral requirement is introduced, and the results from Section 4.2 still hold.

Constrained Gross Settlement Equilibria are Pareto inferior to Unconstrained Gross Settlement, and we can expect that the introduction of a collateral requirement in this case will have more extreme consequences, but they move in the same direction.

The Crash of 1987

The Stock Market Crash of 1987 can be listed among the worst crises that have been recorded in U.S. history: approximately \$1 trillion of financial wealth was wiped-out, with the near-failure of the clearing and settlement system that underpins the stock and commodities markets and integrates with the overall payment system. Moreover, the fall in the Dow Jones index between October 16 and 19 of 1987 was significantly higher than the decline observed between October 28 and 29 of 1929. For this section, we rely on the accounts by Brimmer (1989) and Wigmore (1998). Both authors agree on the list of factors that initiated and contributed to the crisis, as we describe below.

The years 1985, 1986 and January-October of 1987 had shown significant increases in the S&P500, in the order of 26%, 15% and 39%, respectively. These increases translated into an initial overvaluation of the stocks in the S&P500 of the order of 27% by the end of September of 1987. Until September of 1987, general expectations and confidence about the future were very high and had translated into significant purchases of the stocks of the S&P500.

However, a set of circumstances were put together mostly during October 11 and 19 of 1987. Among the most important, we can list the following: growing expectations of renewed inflation, a depreciation of the US dollar, and increase in the interest rate that made bond yields more competitive with common stocks, a fading of foreigner investors' confidence, an increased pessimism about the near-term profitability for U.S. corporations, the "unwillingness" of Japan and Germany to stimulate their economies, and a growing concern over federal budget deficits.

The immediate result was a break in expectations that lead to a massive avalanche of sales of the stocks in the S&P500, motivated by a desire to "sell ASAP and take profits while you can." Therefore, there was an enormous volume of sell orders accompanied by a shrinking demand, accelerating the fall in their prices and motivating enormous amounts of margin calls. Under normal circumstances, these margin calls would have been covered with marginal payments at the next day by the latest. However, the extreme reduction in the value of brokers and customers portfolios prevented the receipt of balancing payments through the Clearing and Settlement Services (CSS.)

a) **A Bank's Reaction Function**

As pointed by McAndrews and Potter (2002), there is usually a very high level of payment coordination among the interbank participants of the Payment System. Let P_t^i denote the payments to be made by Bank i at time t , while R_t^i represents the receipts by Bank i from other banks at time t . We now follow McAndrews and Potter (2003) analysis of Bank i 's reaction function, $i=1,2,\dots,I$, as to how much P_t^i relies on R_t^i . Bank i 's reaction function is given by

$$P_t^i = a + b \cdot R_t^i. \quad (42)$$

From (42), the coefficient b would indicate the strength of the dependence of payments on receipts. Using different panel equations based on information for the year 2001, McAndrews and Potter obtain estimated values of b such that $b \in [0.632, 0.765]$, illustrating the high degree of coordination in the functioning of the Payment System⁵².

b) **A Bank's Beliefs**

In simple terms: if Bank i fails to make its payments, the rest of banks in the system have not enough receipts to make their own payments, and there is typically a domino effect that reduces the liquidity and payments in the system. The latter could be interpreted as a significant negative shock that reduces the incentives of banks to interact with a central clearing house, in that banks believe that most other banks will not repay their debts. Under these extremes circumstances, a bank may believe that a renewed interaction with a clearinghouse would cause them to repay their own debt at a loss

⁵² See also Bech and Garrat (2006.)

because they will not be paid back by other banks. Given these beliefs, banks will find that it to their benefit to cut their link from central clearinghouses.

c) An Interpretation of the Crash of 1987 using our Framework.

The negative shock mentioned in the previous section can be interpreted as bad realization of the shock γ^j , such that $\underline{\gamma} \leq \gamma^j < 0$. The optimal rate of default associated with this realization of γ^j is positive given that $\gamma^* = 0$. In this case, strict net settlement and gross settlement yield a set of multiple equilibria displaying strategic complementarities and suboptimal rates of default.

The most important actions and policies implemented by the Federal Reserve System to try to contain the crisis of 1987, according to Wigmore (1998) were: flooding the system with liquidity, bending the legal lending-limits to banks, and persuading the major participants in the Payment System as to get them to provide loans needed by other bank that had been more affected by the crisis. We argue that these actions and policies took the form of debt forgiveness in that they attempted to give all the banks the right incentives to avoid the intrinsic sub optimality of equilibria with rates of default higher than optimal –obtained usually from strict net settlement and gross settlement under these circumstances.)

Conclusions

We have addressed in this model the question of settlement failure, the danger that agents may choose not to repay debts, an option introducing potential strategic complementarities, the existence of which depends on the rules of settling debt. Net settlement with debt forgiveness is shown to free equilibrium behavior from strategic complementarities and lead to a unique, stable and optimal equilibrium. In contrast, strict net settlement rules may result in a multiplicity of equilibria, the best of which may not be optimal and the worst of which features the collapse of the settlement process. Gross settlement, if lacking debt forgiveness, is shown to be no better than strict net settlement, with the same multiplicity of equilibria. When gross settlement forces agents to hold excessive money balances, it is strictly worse than net settlement.

Our model features a deliberately general nonpecuniary (opportunity) cost to default. We find that if this cost is set to zero, the complete collapse of debt markets is the only stable equilibrium under strict net settlement. Nonpecuniary costs to default make possible stable equilibria with less default. Our results with this very general utility cost of default suggest that debt forgiveness will remain playing a central role in preventing excessive default.

A natural extension is to introduce a collateral requirement. We show in Section 4 that introducing collateral reduces the scope for multiplicity of equilibria, as equilibria with universal default disappear. However, it is possible for collateral to generate rates of default that are lower than optimal. The latter, together with the fact that collateral is costly to maintain, lead to the sub optimality of the resulting allocations.

Interesting topics to continue in this line of research are: the determination optimal collateral requirements and the analysis of endogenous default in open economies under alternative exchange regimes.

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THE INCOME STATEMENT FORMAT NEW TRENDS FROM THE ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS) AND EXTENSIBLE BUSINESS REPORTING LANGUAGE (XBRL)

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Abstract:

The Annual Report is a good mean of describing the situation of a company to all the stakeholders although it is difficult to compare Annual Reports coming from different entities. A process of harmonization of European accounting standards was started in order to bring Annual Reports into line and it is currently being carried out through the adoption of IFRS standards.

Once Annual Reports have been created adopting a common accounting standard, the very next step is to code them using the same IT language. If a common computer language is selected, Annual Reports or other documents can easily be compared without recoding and retyping them. The starting point of this process is the definition of an appropriate *taxonomy* to be used by both those drafting and reading the documents. The process of adopting an appropriate set of accounting standards, selecting the related taxonomy and, finally, drawing up documents using a new business language, called eXtensible Business Reporting Language (XBRL) leads companies to produce sound, meaningful and clear documents that greatly improve sharing of useful information. Moreover, the adoption of IFRS standards and XBRL encoded statements provides a set of measures for building sound and widely accepted models.

The aim of the present paper is to analyze the changes to income statement presentation and the new concept of financial performance that emerges as a result of the adoption of IFRS and XBRL language. The drawing up of the Income Statement by XBRL may improve the financial performance measurement and disclosure with many benefits for all the stakeholders.

Key Words: Income Statement, Financial Performance, IFRS, XBRL, taxonomy

Introduction

The Annual Report is a good mean of describing the financial performance of a company to all the stakeholders although it is difficult to compare Annual Reports coming from different entities. A process of harmonization of European accounting standards was started in order to bring Annual Reports into line and it is currently being carried out through the adoption of IFRS standards.

Once Annual Reports have been created adopting a common accounting standard, the very next step is to code them using the same IT language. If a common computer language is selected, Annual Reports or other documents can easily be compared without recoding and retyping them. The starting point of this process is the definition of an appropriate *taxonomy* to be used by both those drafting and reading the documents. The process of adopting an appropriate set of accounting standards, selecting the related taxonomy and, finally, compiling documents using XBRL language leads companies to produce sound, meaningful and clear documents that greatly improve sharing of useful information. Moreover, the implementation of IFRS standards and XBRL encoded statements provides a set of measures for building sound and widely accepted models.

This process will be of great interest to the end users as it reduces the time and costs required for document preparation and also enables more efficient and less expensive distribution and transmission of the same. Further more, users such as all the company stakeholders, will receive the

reports more quickly and they will be able to analyze documents in an easier and more effective way, because they won't need to retype the reports themselves.

The implementation of the IFRS standards has brought about a radical change in certain key aspects of the drawing of the financial statements. One of the themes that will be affected by this revision process is the concept of income formation, and therefore the IFRS approach to the Income Statement structure (IAS 1, *revised 2007*). The changes to income statement presentation and the new concept of financial performance that emerges as a result of the adoption of IFRS lead to some research questions:

RQ1: How should XBRL be applied in drawing up the financial statements, including the income statement?

RQ2: What may be the impact of adopting the IFRS taxonomy?

RQ3: Will there be positive effects in terms of the performance disclosure?

The remainder of this paper is set out as follows: Section 2 explains the interrelations between the IFRS Income Statement format and XBRL language, Section 3 focuses on a Discussion Paper on Financial Statement Presentation (IASB, 2008), Section 4 emphasizes the benefits arising from the adoption of XBRL in terms of performance disclosure, and finally Section 5 describes the summary and conclusions.

IFRS-compliant Income Statements and XBRL language

IFRS development is indissolubly linked to the adoption of XBRL⁵³: in 2001 the IASB⁵⁴ assumed jurisdiction over XBRL (<http://www.iasb.org/xbml>), i.e. the institutional role required to set up the official IFRS taxonomy. From the very beginning, XBRL played a central and strategic role in the activities of the Board, which deemed it vitally important to define a high-quality taxonomy in order for “the development of IFRSs and the availability of a high quality IFRS Taxonomy based on XBRL standards go hand in hand⁵⁵”. Thus, taxonomy was developed in parallel with the accounting principles: in fact, the XBRL team operating within the Board agreed to publish the Taxonomy within the same time frame planned for the publication of the *Bound Volume*, in addition to ensuring its quality through an appropriate development process. To create the taxonomy, it is not enough to simply transfer information from paper (the *Bound Volume*) to an electronic medium (the XBRL format): two key roles play a part in this process, the computer architecture manager and the project manager in charge of defining the accounting characteristics of the taxonomy, who participates in the meetings of the Board's technical teams responsible for setting up the accounting principles. In summary, several issues arise from the definition of an IFRS taxonomy, of which the following are relevant for the purposes of this work:

1. while it allows a more effective international circulation of economic and financial data, the XBRL language requires the definition of a shared set of accounting principles to use as the source for defining the taxonomic dictionary;

2. on the one hand, the new electronic format is extremely flexible enabling a choice between different financial statement presentation models and accounting record calculation methods; on the other, however, it influences the financial statement presentation form by identifying standard labels to be associated to the different items;

⁵³ Both IFRSs and XBRL are intended to standardize financial reporting in order to promote transparency and to improve the quality and comparability of business information, therefore the two form a perfect partnership. The IFRS Foundation XBRL Team is responsible for developing and maintaining the XBRL representation of the IFRSs, known as the IFRS Taxonomy. The IFRS Taxonomy is used around the world to facilitate the electronic use and exchange of financial data prepared in accordance with IFRSs. The IFRS Foundation's XBRL activities include: Taxonomy development- for companies reporting in IFRS, the Foundation publishes tags for each IFRS disclosure. These tags are organized and contained within the IFRS Taxonomy. Support materials- the Foundation produces support materials to facilitate use and understanding of the IFRS Taxonomy. Translations- translations of the IFRS Taxonomy into key languages are provided to support users of IFRSs and the IFRS Taxonomy whose primary language is not English. Global outreach- the Foundation makes a concerted effort to promote the use of XBRL in conjunction with IFRSs around the world. The Foundation also encourages co-operation and communication with users of the IFRS Taxonomy. See www.iasb.org.

⁵⁴ Please note that the IASC Foundation, as established jurisdiction, was one of the founding members of XBRL International, the non-profit consortium, with the task of developing and promoting the new business and financial language.

⁵⁵ From the speech given by Gerrit Zalm, Chairman of Trustees, during the 17th XBRL International Conference organized by XBRL International in May 2008, available at <http://www.iasb.org>.

3. while IFRS translation into XBRL language helps to improve disclosure in terms of comparability, it does not play a mere role of “container”, but rather it standardizes the method of transmission of business and financial data.

This would undeniably result in benefits, including greater comparability between financial statements through the use of a standardized encoding system and the possibility of using a huge amount of qualitative and quantitative information that could be very conveniently accessed using tags and links. However, the key issue remains the definition of an adequate, complete, reliable and high-quality taxonomy, without which XBRL, as an open standard, has no reason to exist. The purpose of the taxonomy, conceived as a sort of XBRL “dictionary”, is not only to classify the items by identify the contents as part of a hierarchical structure, but can also “understand” the quantitative relations between data, regulatory references, and representation criteria⁵⁶.

The matching of taxonomy and actual disclosure present in companies’ annual reports is perhaps the most critical issue with respect to XBRL impact on business and financial reporting. The creation of an instance document “imposes” the association of each accounting item with a single XML tag, which results in a need to harmonize taxonomy with accounting practices (Baldwin, et al., 2006). In the presence of regulations imposing strict financial statement formats, this is not a problem, but such is not the case with the set of IFRS accounting principles, as discussed above. The same problem arises in connection with the translation into XBRL of the narrative parts (“notes”) and of information voluntarily provided in the annual report. This could have negative effects in terms of reduced transparency and comparability, discouraging companies from voluntarily converting business and financial information into XBRL⁵⁷.

The inadequate fit between taxonomy and common accounting practices⁵⁸ and the companies’ unwillingness to change their accounting policies lead to two different types of behaviors:

- 1) the use of custom tags⁵⁹ added to the XBRL taxonomy;
- 2) the use of extensions common to a certain number of companies, generally operating in certain sectors. The first option results in extreme flexibility of the XBRL language: the contents of the disclosure are broad and can be constantly modified due to the open-source structure of XBRL (Arnold et al. 2009; Locke et al., 2007). The second option is present in many jurisdictions: to quote

⁵⁶ Taxonomies may be distinguished on the basis of a hierarchical classification structured according to the so-called three tier approach: 1) GAAPs applicable to all entities; 2) sector-specific principles; 3) firm-specific principles.

⁵⁷ The IFRS Foundation is establishing a task force to examine detailed XBRL tagging in IFRS (International Financial Reporting Standards) financial statements, and is looking to work directly with preparers from listed companies from different industries and regions. The Foundation has initiated the task force as a follow-up to the pilot initiative that it recently concluded with US-listed foreign companies to produce US-SEC (United States Securities and Exchange Commission)-compliant IFRS financial reports in XBRL format. The objectives of this initiative are: The aim of the task force is for listed companies to produce fully-tagged financial statements using the IFRS Taxonomy. Detailed tagging up to level-4 will be applied to participants’ financial statements, whereby all primary financial statement line items and notes disclosures will be tagged using the IFRS Taxonomy 2011 (which is published at the end of March 2011). The task force will be a means for the Foundation to engage with stakeholders and obtain feedback on the usability of the IFRS Taxonomy for filers and for users of filed XBRL content in the context of detailed note tagging. The IFRS Foundation is seeking participation from preparers of financial statements for listed companies who report in IFRS. Participation from companies operating in all industries and geographical regions is welcome, and it would be particularly useful to have participation by foreign private issuers listed in the United States because of the expected requirement for foreign private issuers reporting in IFRS to submit IFRS XBRL filings from June 2011. Participating companies will: 1) examine major sections within financial statements - such as operating segments, share-based payments, property, plant and equipment, etc - and the corresponding parts of the IFRS Taxonomy that relate to disclosures within those sections, with support and feedback from the IFRS Foundation XBRL Team. 2) Apply IFRS Taxonomy tags to financial statement note disclosures either in Microsoft Excel or Word or directly in XBRL, again with support and feedback from the IFRS Foundation XBRL Team. 3) Generate an XBRL file using their preferred software. For more details see www.iasb.org. available from 21 march 2011.

⁵⁸ Some interesting empirical studies have been conducted in the following works: evaluation of the fit of the taxonomy developed in 2000 for US commercial and industrial companies, in Bovee M., Ettredge M., Srivastava R.P., Vasarhely M., (2002) “Does the Year 2000 XBRL Taxonomy Accomodate Current Business Financial Reporting Practice?”, *Journal of Information System*, vol. 16, n. 2, fall, pages 165-182; the evaluation of the effectiveness of the IFRS-GP taxonomy, developed for the conversion of IFRS-compliant financial statements, in Bõnson E., Cortijo V., Escobar T., (2009) “Towards the Global Adoption of XBRL using International Financial Reporting Standards”, *International Journal of Accounting Information Systems*, vol. 10, pages 46-60.

⁵⁹ We find particularly interesting the possibility of “customizing” contents according to the different categories of stakeholders. “Continuous delivery of customized and standardized external reporting is now possible through enterprise-wide systems, wide-area, high-bandwidth networks, and XML”. (Hunton et al., 2003).

but one, in the US a framework including different components has been developed for the US GAAPs. The components are organized into different levels: add-on taxonomies, common terms, common relations, and industry relationships, which are basically industry-specific extensions. The different taxonomies are applicable both to listed and unlisted companies; three industry-specific taxonomies are currently recognized: industrial and commercial entities, banking and savings institutions, and insurance companies. (Hoffman C., Homer B., 2005, US GAAP Taxonomy Framework, available at www.xbrl.org). The extensions choice appears to be preferable to the adoption of firm-specific custom tags: on the other hand, the risk exists that an excessive number of taxonomies (a “Tower of Babel” of tags according to Bergeron, 2003) will cause an “anti-standardization” effect, leading to the creation of multiple business/financial dialects (Carpenter, 2003).

In summary, one can largely agree with the following opinion on consistency and comparability: “The use of XBRL tags combined with a clearly defined XBRL taxonomy will reduce terminology issues related to homonyms and synonyms in published financial statements⁶⁰. A trade-off exists between a comprehensive taxonomy allowing firm specific information and standardization that improves comparison among firms (Wagenhofer, 2003). XBRL facilitates comparability among firms when common taxonomies are used, but when companies create their extension taxonomy, some of that comparability is lost. The use of extensions should decrease over time as the number of sector taxonomies increases (Debreceeny et al., 2005). However XBRL per se does not resolve the inconsistency of measurement allowed by GAAP”. (Baldwin et al., 2006).

The other possibility available to companies is that of modifying XBRL encoded information: clearly, this is only possible if the information is provided voluntarily, although it is particularly interesting to observe, also for mandatory disclosures, the choices adopted by companies in the presence of different alternatives, the so-called options that are frequently found in IFRS principles. The consequence could be a worsening – in both quantitative and qualitative terms – of the disclosure, as companies might prefer to reduce the degree of detail of the disclosure (Bovee et al. 2002). Another issue is the adjustment of the disclosure contents to the taxonomy’s hierarchical relations, which could result in problems for the users in terms of reprocessing the data through software able to detect certain encoded data only.

Discussion Paper Preliminary View of Financial Statement Presentation October 2008

Lastly, it is worthwhile to discuss briefly the recent developments in the IASB-FASB joint project, making reference to the Discussion Paper issued by the Board in October 2008, on the basis of which a draft was issued (Staff draft of Exposure Draft IFRS X Financial Statement Presentation, July 2010) that could provide a reference basis for a further revision of IAS 1 (see Figure 3 and 4).

The project’s main proposals are:

- 1) cohesive financial statements that share a common structure, separately presenting operating, investing and financing activities as well as income tax and discontinued operations;
- 2) disaggregation in each financial statement, considering its function, nature and measurement basis, with some disaggregation included in the notes;
- 3) more disaggregation of operating cash receipts and payments, and reconciliation of profit or loss from operating activities to cash flows from operating activities;
- 4) analyses of changes in asset and liability line items (including net debt – IASB only);
- 5) and disclosure of remeasurement information



Figure 2: Financial Statement presentation project

⁶⁰ Problems encountered in automatically processing untagged financial information are well documented by FRAANK system. See Bovee et al. 2005.

The proposals would improve the comparability and understandability of information presented in financial statements, by imposing some degree of standardization in the way that information is presented in the financial statements, particularly regarding how information is classified, and the degree to which it is disaggregated.

In particular, we will focus on proposals 1, 2 and 5. In the last few years, the prevalent direction followed by international standard setters has been to increase the decision relevance of financial disclosures. However, both the IASB and the FASB have remained firm in the belief that the financial statements play a crucial role in informing users: “How an entity presents information in its financial statements is vitally important because financial statements are a central feature of financial reporting – a principal means of communicating financial information to those outside an entity”.

Two basic issues are highlighted: 1) the presence of too many alternatives allowed in presenting the financial statements; 2) the information is presented in excessively aggregated form and inconsistently, so that it is not possible to understand the connection between the financial statements and the company's results or financial performance.

The DP has two key purposes, described in the section entitled “Core principles of financial statement presentation” (page 12 of the Staff draft):

1) **Portray a cohesive financial picture of an entity’s.** A cohesive financial picture means that the relationships between items across financial statements is clear and that an entity’s financial statement complement each other as much as possible.

2) **Disaggregate information so that it is useful in predicting an entity’s future cash flows.** Financial statement analysis aimed at objectives such as assessing the amount timing, and uncertainty of future cash flows require financial information that is disaggregated into reasonably homogenous groups of items. If items differ economically, users may wish to take into account differently in predictive future cash flows.

The two fundamental principles that are proposed are: 1) cohesiveness; 2) disaggregation; the strong complementarity between the two principles is emphasized: “The disaggregation and cohesiveness principles work together to enhance the understandability of an entity’s financial presentation”.

Financial statement presentation must be centered on the methods according to which the value creation process occurs within the company, and therefore the information concerning business activities must be separate from the information through which the company finds financing sources to conduct business (financing activities). This is useful in that the information “about non-owner sources of finance (and related changes) should be presented separately from owner sources of finance (and related changes)⁶¹”. Similarly, the need is pointed out to record information on “continued operations” separately. The proposed classification table for the three main statements in the annual report⁶² is shown below; as can be seen, the triple distinction appears to be strictly complementary.

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
<i>Business</i> <ul style="list-style-type: none"> • Operating assets and liabilities • Investing assets and liabilities 	<i>Business</i> <ul style="list-style-type: none"> • Operating income and expenses • Investment income and expenses 	<i>Business</i> <ul style="list-style-type: none"> • Operating cash flows • Investing cash flows
<i>Financing</i> <ul style="list-style-type: none"> • Financing assets • Financing liabilities 	<i>Financing</i> <ul style="list-style-type: none"> • Financing asset income • Financing liability expenses 	<i>Financing</i> <ul style="list-style-type: none"> • Financing asset cash flows • Financing liability cash flows
<i>Income taxes</i>	<i>Income taxes</i> on continuing operations (business and financing)	<i>Income taxes</i>

⁶¹ PVF Document, reduced, page xiv.

⁶² The statements are: Statement of Financial Position, Statement of Comprehensive Income, Statement of Cash Flow. The statement of changes in equity, mandatorily required under the IFRS, “is not included in this table because it would not include the sections and categories used in the other financial statements”. PVF Document, reduced, page xiv.

<i>Discontinued operations</i>	<i>Discontinued operations</i> , net of tax	<i>Discontinued operations</i>
	<i>Other comprehensive income</i> , net of tax	
<i>Equity</i>		<i>Equity</i>

Table 1: Classification Table (PVF document, reduced available at www.ifrs.org)

The rules proposed by the Board (“*Classification guidance*”) to prepare these statements require a sort of “parallelism” on how to enter the accounting records in the three statements: the choice made by the company on where to record the assets and liabilities into the sections and the categories of the Statement of Financial Position reflects on the entry of accounting records in the other two statements, the statement of comprehensive income and cash flows. The statements below appear to be relevant in that the Board expresses the intention to apply to the Financial Statement Presentation Guidelines the so-called Management Approach, already present in IFRS 8 “Operating segment”, effective as of 2009, replacing the previous principle, IAS 14⁶³. “Classification should be consistent with how the asset or liability is used within an entity and the way an entity views its activities; an entity with more than one reportable segment should classify items according to how they are used in its reportable segments. This approach should allow management to communicate the unique aspects of its business(es) to users of its financial statements. The classification decision would reside with management and its classification rationale would be presented in the notes to Financial Statements as part of the accounting policy discussion. The Boards support a management approach to classification rather than a prescriptive approach because they believe it will result in financial statements that reflect how management views and manages the entity and its resources”.

Therefore, this perspective allows the representation of data in the financial statements “through the eyes of management”, enabling users to “read” the corporate reality from an internal point of view, as if they were assuming the functions of the management itself. This reasoning makes realistic the third key concept set forth in the Jenkin’s Committee Report: 1) Explain the nature of a company’s businesses, including the linkage between events and activities and the financial impact on company of those events and activities; 2) Provide a forward-looking perspective; 3) Provide management’s perspective.

In effect, the Committee had put into practice the users’ wish to perceive the company’s business through the principles, values and culture of the managers who operate within the company. From the point of view of the users, being informed of the measurements and indicators built for the senior management facilitates their understanding of future strategies and helps to estimate the actual value of the company.

From the point of view of data presentation methods, the primary purpose is the cohesiveness principle that must characterize the financial statements, and XBRL is more than a means of communicating information, it is also a powerful tool for presenting it. In fact, the Boards request as follows: to present a cohesive set of financial statements, an entity should align the line items, their descriptions, and the order of presentation of information in the statements of financial position, comprehensive income, and cash flows. To the extent that it is practical, an entity should disaggregate, label, and total individual items similarly in each statement. Doing so should present a cohesive relationship at the line level among individual assets, liabilities, income, expense, and cash flow items” (page xv).

The benefits of XBRL for the performance measurement and disclosure

No mention of XBRL is found in the IASB-FASB joint project: nonetheless, the proposed innovations – i.e. the need to present data in a “cohesive” manner and at the same time to “disaggregate” the information – could find considerable benefits in XBRL. “XBRL tagged data enables users to see financial data in multiple different formats and using multiple different assumptions, consistent with a bottom up demand-pull vision of financial reporting” (Alles, Piechocki, 2009). The main difficulty is the excessive importance attributed to compliance with certain models of financial statements and notes. It is stated, therefore, that one of the decisive shifts

⁶³ The adoption of this approach is one of the major differences compared to the previous IAS 14 principle. The US adopted this approach back in 1997, when the Statement SFAS 131 was issued.

in this perspective, in the case of XBRL tagged data, will be the shift from document-centric taxonomies to data-centric taxonomies.

The joint project (DP and ED) focuses on interesting aspects that should help to strengthen the “multidimensional modeling” of financial information. To this effect, for example, the income statement currently envisaged in the IFRS taxonomy may be modified, as shown in Figure 3.

Figure 4 presents line items from the XBRL IFRS taxonomy income statement (a similar model approach can be found in the vast majority of XBRL taxonomies) The distinction between continuing and discontinued operations is provided on a line item level, for example, Profit (loss) from discontinued operations is a different line item from Profit (loss) from continuing operations and both as distinct from the aggregate Profit (loss) line item.

The same income statement could be modeled by the means of axes thus leading to a more consistent and logical multidimensional data model. The ownership (the categorization into line items attributable to owners of parent or non-controlling interest or aggregate ownership) as well as the distinction into line items referring to continuing and discontinued operations can be modeled by means of axes thus creating a model presented in Figure 4.

While not directly required by IFRS, the Revenue line item can logically also be reported as Revenue from Discontinued operations and Attributable to owner of parent. In practice a number of financial statements provide such financial information although the current IFRS taxonomy does not directly foresee such a possibility.

Income statement		
Profit (loss)		
Revenue		
Cost of sales		
Gross profit		
Other income		
Distribution costs		
Administrative expense		
Other expense		
Other gains (losses)		
Finance income		
Finance costs		
Share of profit (loss) of associates and joint ventures accounted for using equity method		
Profit (loss) before tax		
Income tax expense		
Profit (loss) from continuing operations		
Profit (loss) from discontinued operations		
Profit (loss)		
Profit (loss), attributable to		
Profit (loss), attributable to owners of parent		
Profit (loss), attributable to non-controlling interests		
Earnings per share		
Basic earnings per share		
Basic earnings (loss) per share from continuing operations		
Basic earnings (loss) per share from discontinued operations		
Basic earnings (loss) per share		
Diluted earnings per share		
Diluted earnings (loss) per share from continuing operations		
Diluted earnings (loss) per share from discontinued operations		
Diluted earnings (loss) per share		

Figure 3: Income Statement model in XBRL IFRS Taxonomy.

Multidimensional modeling may also be applied to the statement of financial position, where in the current taxonomy the individual values are recorded partly on a current and partly on a non-current basis, while a distinction between operating, financing and investing, and aggregate activities may also be recorded, and these in turn may be entered as partly current and partly non current.

Additionally, multidimensional modeling by the means of XBRL increases the analytical capabilities especially for selecting (*slicing* and *dicing*) appropriate data and viewing them in appropriate way. For analysis of the Revenue, Cost of sales and Other income, and their classification into “Attributable to owners of parent” or “Attributable to non-controlling interest or for all aggregate ownership operations, a simple operation on the multidimensional data model can be conducted leading to the result presented in Alles, Piechocki, 2009.

	Aggregate ownership					
	Attributable to owners of parent				Attributable to non-controlling interest	
	Aggregate continuing and discontinued operations		Aggregate continuing and discontinued operations		Aggregate continuing and discontinued operations	
	Continuing operations	Discontinued operations	Continuing operations	Discontinued operations	Continuing operations	Discontinued operations
Income statement						
Profit (loss)						
Revenue						
Cost of sales						
Gross profit						
Other income						
Distribution costs						
Administrative expense						
Other expense, by function						
Other gains (losses)						
Finance income						
Finance costs						
Share of profit (loss) of associates and joint ventures accounted for using equity method						
Profit (loss) before tax						
Income tax expense						
Profit (loss)						
Earnings per share						
Basic earnings (loss) per share						
Diluted earnings (loss) per share						

Figure 4: Modeling of Income Statement by the means of axes

As it may be noted, the use of the XBRL technology and the introduction of the axes suggested in the Presentation of Financial Statements Project of the IASB and FASB bring about a significant change: the presentation itself become less relevant with the enhanced analytical capabilities playing the predominant role.

This reminds us of Hoffmann’s definition of the XBRL specification (1998): “XBRL is the specification of the eXtensible Business Reporting Language (which) allows software vendors, programmers, (and) intermediaries in the preparation and distribution process and end users who adopt it as a specification to enhance the creation, exchange, and comparison of business reporting information”. This significant statement underlies all XBRL specifications. It shows that the orientation of the XBRL Consortium is towards enabling XBRL for use in the financial information value chain. Willis and Hannon (2005) state that to achieve this goal XBRL provides a common standardized format that enables applications to seamlessly share and process data.

The taxonomies reflect the existing accounting standards (IASCF, 2008) and/or reporting best practices (XBRL US, 2008). The process of taxonomy development encompasses the creation of a data model on the basis of accounting standard (or other sources of information) and instantiating of the data model by the means of XBRL specifications. In the case of the IFRS taxonomy the underlying legal source are the IFRSs. XBRL has evolved from a simple transmission protocol for financial information into a comprehensive set of technologies which supports data modeling (and more importantly, multidimensional data modeling with XBRL Dimensions), financial data querying and setting of business rules (XBRL formulas) and also the visualizations of business information (Inline XBRL and XBRL rendering).

The evolution of XBRL technology was not followed by a similar development in the accounting standard issuing process: we still find a strong bias towards document-oriented financial reporting, since considerable importance is attributed to the distinction between statements and notes. “While such an approach is based on tradition for accountants it is not the optimal approach for IT and data modeling experts or for data analysts. The latter have moved towards a more analytical view of business information which leads to multidimensional modeling with possibilities to **slice, dice, pivot or rotate multidimensional data**. XBRL has recently attempted to bridge this gap by offering multidimensional modeling of accounting standards (Alles, Piechocki, 2010).

Although it is used in IFRS and US GAAP taxonomies, the multidimensional approach has broader use possibilities, as for example in the case of COREP and FINREP⁶⁴ taxonomies. The introduction of the dimensional specification leads to a fundamental shift towards “more data-centric” and “less document-centric” taxonomies. This aspect also emerges from a comparison between IFRS and US GAAP taxonomy: the former follows a balanced approach between data and document orientation, for example, by using concept per cell in the tables for the movements in property, plant and equipment while disclosure of operating segments is expressed by the means of dimensions. By contrast, the US GAAP taxonomy introduces dimensions for a significant number of schedules which reduces the number of concepts in the taxonomy as well as better reflecting the relationships among the concepts.

This makes the multidimensional approach of the US GAAP taxonomy more similar to that of the FINREP and COREP taxonomies. For example, the architecture used to design the table structures of the IFRS taxonomy does not use XBRL dimensions; the use of multidimensional entities is limited to the modeling of certain reports at the instance level (e.g. breakdown by geographical areas). COREP, in particular, is a highly dimensional taxonomy utilizing up to seven dimensions (axes) in one hypercube (by comparison, the IFRS and the US GAAP taxonomies, usually provide only one dimension for a given measure – for example, Revenue reported for breakdown of Geographical area).

Another aspect that emerges from the joint project is the possibility of both Statement of financial position data and, consequently, Income Statement data in such a way as to identify the three types of activities: operating, financing and investing. “The presentation of assets and liabilities in the business and financing sections will clearly communicate the net assets that management uses in its business and financing activities. That change in presentation coupled with the separation of business and financing activities in the statements of comprehensive income and cash flows should make it easier for users to calculate some key financial ratios for an entity’s business activities or financing activities.

This facilitates the calculation of certain indexes: this is another aspect that highlights the remarkable use potential of XBRL. The possibility of accessing “tagged in depth” XBRL data is essential and, together with the proposal to modify financial statements as discussed above, represents a basic opportunity for stakeholders – specifically, it leads to strong simplification in the performance of business analyses. The real power of XBRL is *democratization* of financial data, giving the user rather than the firm, or the regulator, control over how data is presented and perceived. Of course, the firm and the regulators would still determine what information is publicly released, but when that data is XBRL tagged the user obtains the ability to slice and dice that data as they choose and not be constrained to view the data in only the way the firm chooses to display it. Such a capabilities already exists if the users is willing to rekey in the data in public financial statements into their own data analysis system, but that entails high cost and can only be undertaken by such professionals as analysts, or those with the resources to purchase reformatted data from data intermediaries. With XBRL tagging anyone can examine data in any way they choose at very low cost, which is why we argue that XBRL will increase access to financial data and so “democratize” it. Another aspect is the possibility to liberate the substance of financial data from its form, avoiding any conditioning linked

64 The Committee of European Banking Supervisors (CEBS) models the taxonomies for Common Reporting (COREP) and Financial Reporting (FINREP). While COREP reflects the Basel II regulations for reporting of solvency ratio and is stand-alone taxonomy, FINREP reflects the financial reporting of financial institutions based on IFRS and is extension of IFRS taxonomy. These are the first multi-dimensional taxonomies, i.e. taxonomies compliant with XBRL . Dimensions 1.0 specifications, and were developed in 2006. Since then, XBRL Dimensions have received growing attention from international XBRL experts. Many taxonomies intend to adopt this module during their periodical revision process.

to the way in which data are presented in the financial statements. This is authoritatively confirmed by Mike Willis of PWC and Founding Chairman of XBRL International, in whose words: “XBRL-enabled democratization of financial markets will provide enhanced analytical, presentation and referential insights that are developed by consumers collaborating with standardized disclosure, analytical and referential concepts in public and/or proprietary social networks in a manner similar to the current mediums such as Facebook or Wikipedia⁶⁵”.

Another problem is related to the need to obtain data in real time: as an example, we could quote empirical research studies conducted by scientists using data obtained very late and with few possibilities of providing information that will help the managers' decision making process. The use of XBRL tagged data and real-time reporting may enable managers to carry out the same analyses that are generally conducted by third party aggregators. “XBRL thus enables analysts, auditors and boards of directors to replicate an academic analysis for their firms more easily, in time to be actionable”. (Alles, Piechocki, 2010, page 10)

With specific reference to profitability indexes, the calculation of adequate financial ratios may improve corporate performance measurement, with beneficial effects in terms of improvement of the governance decision-making process, which represents the last step in the information value chain (Elliot, 1998).

Conclusion

The aim of this paper is to analyze the connection that links financial performance, adoption of IFRS standards and XBRL language. The first point was that the adoption of IFRS standards greatly improved the disclosure of performance information itself. The very next step was to emphasize the relevant role of XBRL in improving business reporting. By means of XBRL, it is possible to provide a sound framework for the measurement and evaluation of Business Performance by means of a specific set of Key Performance Indicators (KPIs). In particular, we emphasized the potential benefits of the use of XBRL in providing integrated reports in a more timely and accurate manner.

As the worldwide financial crisis continues, calls for greater transparency in financial reporting are increasing (Laux, 2009). The adoption of IFRS standards may only partially fulfil these requests. While the current GAAP reporting model provides an effective foundation from which business reporting should start, timely decisions can only be made by looking at both lagging indicators (such as those found in historical financial statements) and leading indicators (such as value drivers and KPIs), which provide more predictive information about future cash flows and the viability itself of a business. Although this is the kind of information that management currently uses to make key decisions, there is still a fracture within the corporate reporting process between the information that management uses internally for decision-making purposes, and the one that is provided externally to the market-place (Laux, 2009).

The development of XBRL taxonomy may produce benefits because the high level items within this framework can be “tagged”. XBRL enables providers and users of information to produce, capture and analyze information much more efficiently and effectively on a timely basis and across all software via the Internet. Coupled with the Internet – which allows key financial and nonfinancial business information to be widely available electronically – XBRL will enable a more effective utilization of financial disclosure. Some stakeholders in particular will be strongly interested in this process. Financial institutions and financial analysts will spend less time on technical issues about data and thereby will have more time for analyses and evaluations.

The analysis of financial information is based on a three-step process: 1) data gathering and data enter; 2) data cleaning, data reclassification and data merging; 3) data analysis and data evaluation. By means of XBRL it is possible to drastically reduce the time to devote to the first two steps, thereby increasing the time available for the latter step. In addition, XBRL will make it easier for companies to track the performance of competitors and customers, and to benchmark their own performance (Kugel, 2008). The impact of IFRS and XBRL on performance measurement and disclosure will affect both financial reporting and Business Performance Management (BPM) processes. Financial reporting is the window through which capital markets view a business's performance. The move to IFRS will not only affect accounting and reporting functions, but also

65 Comments made at the academic track of the 19th XBRL International Conference in Paris, June, 2009.

investor relations and all other areas of the business that rely on accounting information – including tax, IT, HR, and legal departments.

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ESTIMATION OF POPULATION DENSITY BASED ON LINE TRANSECT DATA WITH AND WITHOUT THE SHOULDER CONDITION

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Abstract:

In this paper, new nonparametric estimators for the population density D using line transect sampling are proposed and studied. One estimator is developed when the shoulder condition is assumed to be true and another one when this assumption is violated. The mathematical and numerical properties of these estimators are investigated and compared -via simulation technique- with other existing estimators. A new technique is suggested to combine the proposed estimators. This technique relies on testing the shoulder condition, which in turn produces two new estimators. The simulation results show the good potential performances of the different proposed estimators.

Key Words: Line transect method, Shoulder condition, Estimation of abundance, Kernel method, Smoothing parameter, Boundary effect

Introduction

Line transect method is a popular and convenient technique used to estimate the density (abundance) of a biological population D , since it is direct, cost efficient and can be carried out on foot, or from a variety of land, air, or watercraft. Assume that the population size is N and the sampled area is A then the population density is $D = N/A$. In line transect method, an area of known boundaries and size is divided into non-overlapping strips, each with known length. Then an observer moves on the middle of line of the strip and records the perpendicular distance x from the centerline to a detected object within the strip. The total length of lines l_1, l_2, \dots, l_k is denoted by L .

The detection function $g(x)$ represents the probability of detecting an object given that its perpendicular distance is x . The logical assumptions on $g(x)$ are (Burnham et al., 1980) $g(x)$ must be monotonically decreasing and objects directly on the transect line will never be missed (i.e., $g(0) = 1$).

Suppose that the observer detected n objects with perpendicular distances X_1, X_2, \dots, X_n . These perpendicular distances form a random sample of size n that follows a specific pdf $f(x)$. Burnham and Anderson (1976) introduced the basic relationship between $g(x)$ and $f(x)$, which is given by

$$f(x) = \frac{g(x)}{\int_0^w g(t)dt}, \quad 0 \leq x \leq w \quad (1.1)$$

where w is a truncated distance. They gave the fundamental relationship between $f(0) = \left[\int_0^w g(x)dx \right]^{-1}$ and the population abundance, D , which can be expressed as

$$D = \frac{E(n)f(0)}{2L}, \quad (1.2)$$

where n is the number of detected objects, $E(n)$ is the expected value of n , and L is the total length of the transect lines.

The estimation of D can be accomplished via the estimation of $f(0)$ by (Burnham et al., 1980)

$$\hat{D} = \frac{n\hat{f}(0)}{2L}, \quad (1.3)$$

where $\hat{f}(0)$ is an estimator of $f(x)$ evaluated on the transect line (i.e., at $x=0$). As Equation (1.3) demonstrates, the crucial problem in line transect sampling is to estimate $f(0)$ by $\hat{f}(0)$. This leads us to obtain the estimation of density D by \hat{D} . Moreover, the estimation of D is equivalent to estimate the number of objects N in a specific known area A . Therefore, the estimation of N can be accomplished by $\hat{N} = A\hat{D}$.

The estimator $\hat{f}(0)$ can be obtained by using a parametric approach or a nonparametric approach. The first one assumed that the form of the probability density function $f(x;\theta)$ is known with unknown parameter θ (θ may be a vector). A good statistical method – such as the maximum likelihood method - can be used now to estimate θ and then $f(0;\theta)$. While the parametric method performs well when the form of $f(x;\theta)$ is chosen correctly, its performance is not satisfactory otherwise (Buckland et. al., 2001). As an alternative method to the parametric approach, recent works has focused on employing the nonparametric approach to estimate the parameter $f(0)$ and consequently the parameter D or N . A popular method is the kernel method which becomes an important tool in wildlife sampling (See for example, Chen, 1996, Mack and Quang, 1998 and Eidous, 2005).

Some Estimators of $f(0)$

The condition $f'(0) = 0$ is known in line transect literature as the shoulder condition assumption, which means that the probability of detecting an object in a narrow area around the centerline remains certain. In this section, we presented some existing estimators for $f(0)$.

Chen (1996) suggested the classical kernel estimator for $f(0)$, which is given by

$$\hat{f}_k(0) = \frac{2}{nh} \sum_{i=1}^n K\left(\frac{X_i}{h}\right), \quad (2.1)$$

where h is called the smoothing (or bandwidth) parameter, which controls the smoothness of the fitted density curve and K is the kernel function assumed to be symmetric and satisfies,

$$\int_{-\infty}^{\infty} K(t)dt = 1, \quad \int_{-\infty}^{\infty} tK(t)dt = 0, \quad \int_{-\infty}^{\infty} t^2 K(t)dt = C \neq 0 < \infty.$$

The optimal formula of h can be obtained by minimizing the asymptotic mean square error (AMSE) of $\hat{f}_k(0)$ (see Chen, 1996). Barabesi (2001) proposed a new estimator for $f(0)$ based on local parametric estimation technique. His estimator is given by

$$(2.2) \hat{f}_B(0) = \hat{f}_k(0) \left[\frac{h^2}{\hat{\gamma}^2} + 1 \right]^{\frac{1}{2}}$$

where $\hat{f}_k(0)$ is the classical kernel estimator and $\hat{\gamma}^2 = \frac{\sum_{i=1}^n x_i^2}{n}$. The two estimators $\hat{f}_k(0)$ and $\hat{f}_B(0)$ are developed under the assumption that $f'(0) = 0$. Barabesi's estimator (2.1) can be considered as a special case of Eidous and Alshakhatreh (2011)'s estimator.

Mack et al. (1999) introduced the boundary kernel estimator for $f(0)$ under the assumption that the shoulder condition is not satisfied (i.e. $f'(0) \neq 0$). Their estimator is given by

$$\hat{f}_{ME}(0) = \frac{1}{nh} \sum_{i=1}^n K^* \left(\frac{X_i}{h} \right), \quad (2.3)$$

where K^* is a kernel function satisfying

$$\int_0^{\infty} K^*(u) du = 1, \quad \int_0^{\infty} u K^*(u) du = 0 \quad \text{and} \quad \int_0^{\infty} u^2 K^*(u) du = d \neq 0.$$

Note that the assumptions about K^* are little different from those about K . Here all integrals are defined on $(0, \infty)$. According to Mack et al. (1999), the boundary kernel function that minimize the AMSE of $\hat{f}_{ME}(0)$ is

$$K^*(u) = 6(1 - 3u + 2u^2)I_{(0,1)}(u), \quad (2.4)$$

where $I_B(u)$ is an indicator function of a real set B .

Eidous (2011) proposed a new estimator for $f(0)$ without requiring the assumption $f'(0) = 0$. He named his estimator "additive histogram estimator". The additive histogram estimator is given by

$$\hat{f}_{EE}(0) = \frac{1}{nh} \sum_{j=1}^4 \sum_{i=1}^n k_j I_j(X_i). \quad (2.5)$$

where the constant k_i 's are $k_1 = \frac{107}{60}$, $k_2 = 0.4$, $k_3 = \frac{-59}{60}$, $k_4 = \frac{41}{120}$, h is the bin width, and $I_j(x)$ is the indicator function defined by

$$I_j(x) = \begin{cases} 1, & 0 < x < jh \\ 0, & o.w \end{cases}.$$

The Proposed Estimators

Let X_1, X_2, \dots, X_n be a random sample of perpendicular distances of size n . Under the assumption that $f'(0) = 0$, we propose the following estimator for $f(0)$,

$$\hat{f}_{P1}(0) = \frac{2}{nh} \sum_{j=1}^4 \sum_{i=1}^n r_j K \left(\frac{X_i}{jh} \right), \quad (3.1)$$

where $r_1 = 47/50$, $r_2 = 127/200$, $r_3 = -91/150$ and $r_4 = 61/400$. Let $D_v = \sum_{j=1}^4 j^v r_j$, then

$$D_1 = 1, \quad D_2 = 0.46, \quad D_3 = -0.6. \quad \text{Also,} \quad \text{let}$$

$T(r_1, \dots, r_4) = \int_0^{\infty} K^2(u) du \sum_{j=1}^4 j r_j^2 + 2 \sum_{j=1}^3 \sum_{l=j+1}^4 r_j r_l \int_0^{\infty} K(u/j) K(u/l) du$ and the kernel function

$K(t)$ to be Gaussian function, i.e. $K(t) = N(0,1)$, then $T(r_1, \dots, r_4) = 0.1847$. The optimal value of h can be obtained by minimizing the *AMSE* of $\hat{f}_{P_1}(0)$, which gives $h = 1.206 \hat{\sigma} n^{-\frac{1}{5}}$ when $f(x)$ is assumed to be half normal with scale parameter σ^2 . The illustrations for the use of the above notations are given below. The asymptotic properties of Estimator (3.1) are stated in the following lemma.

Lemma (3.1). Suppose that $f(x)$ is defined on $[0, \infty)$ and has a continuous second derivative at $x = 0$. Under the assumption that $h \rightarrow 0$ and $nh \rightarrow \infty$ as $n \rightarrow \infty$, the expected value and the variance of $\hat{f}_{P_1}(0)$ are,

$$\begin{aligned} E(\hat{f}_{P_1}(0)) &= f(0)D_1 + 2hf'(0)D_2 \int_0^\infty uK(u)du + h^2 f''(0)D_3 \int_0^\infty u^2 K(u)du + o(h^2) \\ &\cong f(0) - 0.6h^2 f''(0) \int_0^\infty u^2 K(u)du, \end{aligned} \quad (3.2)$$

and

$$\begin{aligned} \text{var}(\hat{f}_{P_1}(0)) &= \frac{4f(0)}{nh} T(r_1, \dots, r_4) + o(n^{-1}h^{-1}). \\ &\cong \frac{0.7388f(0)}{nh}. \end{aligned} \quad (3.3)$$

The proof of Lemma (3.1) is given below together with the proof of Lemma (3.2). Note that, because $D_1 = 1$ then $\hat{f}_{P_1}(0)$ is asymptotically ($h \rightarrow 0$ as $n \rightarrow \infty$) unbiased estimator for $f(0)$ and since $f'(0) = 0$ then the convergence rate for bias of $\hat{f}_{P_1}(0)$ is $O(h^2)$. Also note that the variance of $\hat{f}_{P_1}(0)$ converges to zero as $nh \rightarrow \infty$ when $n \rightarrow \infty$.

On the other hand if the shoulder condition is not true (i.e. $f'(0) \neq 0$), then the bias of $\hat{f}_{P_1}(0)$ is of order h , which is significantly larger than the order h^2 as $h \rightarrow 0$. If $f'(0) \neq 0$, we propose the following estimator for $f(0)$,

$$\hat{f}_{P_2}(0) = \frac{2}{nh} \sum_{j=1}^4 \sum_{i=1}^n r_j K\left(\frac{X_i}{jh}\right), \quad (3.4)$$

where $r_1 = 43/30$, $r_2 = 7/10$, $r_3 = -31/30$ and $r_4 = 19/60$. Now if $D_v = \sum_{j=1}^4 j^v r_j$,

then $D_1 = 1$, $D_2 = 0$ and $D_3 = -0.6$. Also $T(r_1, \dots, r_4) = 0.2742$ when the kernel function K is chosen to be Gaussian function (i.e. $K(t) = N(0,1)$). Assume that $f(x) = \frac{1}{\theta} e^{-x/\theta}$, $x \geq 0$ and $K(t) = \frac{1}{\sqrt{2\pi}} e^{-\frac{x^2}{2}}$ then the optimal formula for estimating the

smoothing parameter h is $h = 1.248 \hat{\theta} n^{-\frac{1}{5}}$, where $\hat{\theta} = \bar{X}$.

Lemma (3.2). Suppose that $f(x)$ is defined on $[0, \infty)$ and has a continuous second positive derivative at $x = 0$. Under the assumption that $h \rightarrow 0$ and $nh \rightarrow \infty$ as $n \rightarrow \infty$, the expected value and variance of $\hat{f}_{P_2}(0)$ are,

$$E(\hat{f}_{P_2}(0)) = f(0) - 0.6h^2 f''(0) \int_0^\infty u^2 K(u)du + o(h^2), \quad (3.5)$$

and

$$\text{var}(\hat{f}_{P_2}(0)) = \frac{1.0896f(0)}{nh} + o(n^{-1}h^{-1}). \quad (3.6)$$

Proof of Lemma (3.1) and Lemma (3.2):

Let $\hat{f}_{P_i}(0)$, $i = 1, 2$ be the proposed estimators, where $\hat{f}_{P_1}(0)$ is the Estimator (3.1) and $\hat{f}_{P_2}(0)$ is the Estimator (3.4). The expected value of $K(X / jh)$ is

$$\begin{aligned} EK(X / jh) &= \int_0^{\infty} K(x / jh) f(x) dx \\ &= jh \int_0^{\infty} K(u) (f(0) + jhu f'(0) + (jhu)^2 f''(0) / 2 + (jhu)^3 f'''(0) / 6 + \dots) du \\ &= jhf(0) / 2 + (jh)^2 f'(0) R_1 + (jh)^3 f''(0) R_2 / 2 + (jh)^4 f'''(0) R_3 / 6 + \dots \end{aligned}$$

where $R_z = \int_0^{\infty} u^z K(u) du$. Therefore, the expected value of $\hat{f}_{P_i}(0)$, $i = 1, 2$ is

$$\begin{aligned} E(\hat{f}_{P_i}(0)) &= \frac{2}{h} \sum_{j=1}^4 r_j E[K(X / jh)] \\ &= \frac{2}{h} \sum_{j=1}^4 r_j [jhf(0) / 2 + (jh)^2 f'(0) R_1 + (jh)^3 f''(0) R_2 / 2 + (jh)^4 f'''(0) R_3 / 6 + \dots] \\ &= f(0) D_1 + 2hf'(0) R_1 D_2 + h^2 f''(0) R_2 D_3 + o(h^2). \end{aligned}$$

Now, for estimator $\hat{f}_{P_1}(0)$ we indicated that $D_1 = 1$, $D_2 = 0.46$, $D_3 = -0.6$ and since $f'(0) = 0$, we obtain,

$$E(\hat{f}_{P_1}(0)) = f(0) - 0.6 h^2 f''(0) R_2 + o(h^2).$$

Also, for estimator $\hat{f}_{P_2}(0)$ we obtained $D_1 = 1$, $D_2 = 0$, $D_3 = -0.6$, which gives (without assuming that $f'(0) = 0$),

$$E(\hat{f}_{P_2}(0)) = f(0) - 0.6 h^2 f''(0) R_2 + o(h^2).$$

Note that the bias of the two estimators is of order h^2 .

We turn to the variance of $\hat{f}_{P_i}(0)$, $i = 1, 2$. Suppose that $h \rightarrow 0$ and $nh \rightarrow \infty$ as $n \rightarrow \infty$ then the variance of $\hat{f}_{P_i}(0)$ is

$$\begin{aligned} \text{Var}(\hat{f}_{P_i}(0)) &= \frac{4}{nh^2} \text{var} \left[\sum_{j=1}^4 r_j K(X / jh) \right] \\ &= \frac{4}{nh^2} \left(E \left[\sum_{j=1}^4 r_j K(X / jh) \right]^2 - \left[\sum_{j=1}^4 r_j EK(X / jh) \right]^2 \right). \end{aligned} \quad (3.7)$$

By substituting the expression of $EK(X / jh)$ in the second term of (3.7), then we obtain

$$\begin{aligned} \text{Var}(\hat{f}_{P_i}(0)) &= \frac{4}{nh^2} E \left[\sum_{j=1}^4 r_j K(X / jh) \right]^2 + o(n^{-1}h^{-1}) \\ &= \frac{4}{nh^2} E \left[\sum_{j=1}^4 \sum_{l=1}^4 r_j r_l K(X / jh) K(X / lh) \right] + o(n^{-1}h^{-1}) \end{aligned}$$

$$\begin{aligned}
&= \frac{4}{nh^2} E \left[\sum_{j=1}^4 r_j^2 K^2(X/jh) + 2 \sum_{j < l}^4 r_j r_l K(X/jh)K(X/lh) \right] + o(n^{-1}h^{-1}) \\
&= \frac{4}{nh^2} \left[\sum_{j=1}^4 r_j^2 E(K^2(X/jh)) + 2 \sum_{j=1}^3 \sum_{l=j+1}^4 r_j r_l E(K(X/jh)K(X/lh)) \right] + o(n^{-1}h^{-1})
\end{aligned} \tag{3.8}$$

Now,

$$\begin{aligned}
E(K^2(X/jh)) &= \int_0^{\infty} K^2(x/jh) f(x) dx \\
&= jh \int_0^{\infty} K^2(u) (f(0) + juh f'(0) + (jhu)^2 f''(0)/2 + \dots) du \\
&= jhf(0) \int_0^{\infty} K^2(u) du + o(h).
\end{aligned} \tag{3.9}$$

Also,

$$\begin{aligned}
E(K(X/jh)K(X/lh)) &= \int_0^{\infty} K(x/jh)K(x/lh) f(x) dx \\
&= h \int_0^{\infty} K(u/j)K(u/l) (f(0) + huf'(0) + (hu)^2 f''(0)/2 + \dots) du \\
&= hf(0) \int_0^{\infty} K(u/j)K(u/l) du + o(h).
\end{aligned} \tag{3.10}$$

By substituting (3.9) and (3.10) back into (3.8), we obtain

$$\begin{aligned}
\text{Var}(\hat{f}_{P_1}(0)) &= \frac{4hf(0)}{nh^2} \left[\int_0^{\infty} K^2(u) du \sum_{j=1}^4 jr_j^2 + 2 \sum_{j=1}^3 \sum_{l=j+1}^4 r_j r_l \int_0^{\infty} K\left(\frac{u}{j}\right)K\left(\frac{u}{l}\right) du \right] + o(n^{-1}h^{-1}) \\
&= \frac{4f(0)}{nh} T(r_1, \dots, r_4) + o(n^{-1}h^{-1}).
\end{aligned}$$

Now, for estimator $\hat{f}_{P_1}(0)$, $T(r_1, \dots, r_4) = 0.1847$. This gives,

$$\text{Var}(\hat{f}_{P_1}(0)) = \frac{0.7388f(0)}{nh} + o(n^{-1}h^{-1}).$$

Also, for estimator $\hat{f}_{P_2}(0)$, $T(r_1, \dots, r_4) = 0.2742$. Therefore,

$$\text{Var}(\hat{f}_{P_2}(0)) = \frac{1.0896f(0)}{nh} + o(n^{-1}h^{-1}).$$

This completes the proof. Note that the variance of $\hat{f}_{P_1}(0)$ and $\hat{f}_{P_2}(0)$ is of order $n^{-1}h^{-1}$ (or the convergence rate for the variance of $\hat{f}_{P_1}(0)$ and $\hat{f}_{P_2}(0)$ is $O(n^{-1}h^{-1})$).

Combining the Estimators

In this section, we propose another two estimators for $f(0)$ that combining the two estimators $\hat{f}_{P_1}(0)$ and $\hat{f}_{P_2}(0)$. Let F_0 = the class of all pdfs that satisfy $f'(0) = 0$ and F = the class of all pdfs that are differentiable at 0, and consider the following test,

$$H_0 : f \in F_0 \quad \text{vs.} \quad H_1 : f \in F \setminus F_0. \tag{4.1}$$

According to Mack (1998), H_0 is reject (i.e., the shoulder condition is not true) if $|T| > Z_{\alpha/2}$, where $Z_{\alpha/2}$ represents the $\alpha/2^{\text{th}}$ quantile of the standard normal distribution. The test statistics T is defined by

$$T = S'(0) \sqrt{\frac{nb^3}{2\hat{f}_k(0)}},$$

where $S'(0)$ is estimated by $\hat{S}'(0) = \frac{[F_n(2b) - 2F_n(b)]}{b^2}$, $b = \hat{\sigma} n^{-\frac{1}{4}}$, $\hat{\sigma} = \sqrt{\sum_{i=1}^n x_i^2 / n}$ and $F_n(u) = \frac{\#x_i \in [0, u]}{n}$ is the empirical cumulative distribution function. Based on testing (4.1), we propose the following two estimators for $f(0)$,

$$\hat{f}_{P3}(0) = \begin{cases} \hat{f}_{P1}(0) & \text{if } f \in F_0 \\ \hat{f}_{P2}(0) & \text{if } f \notin F_0 \end{cases}, \quad (4.2)$$

and

$$\hat{f}_{P4}(0) = \alpha \hat{f}_{P1}(0) + (1 - \alpha) \hat{f}_{P2}(0), \quad (4.3)$$

where the estimators $\hat{f}_{P1}(0)$ and $\hat{f}_{P2}(0)$ are given by (3.1) and (3.4) respectively. The parameter $\alpha \in [0, 1]$ represents the weight of $\hat{f}_{P1}(0)$ in the final estimator $\hat{f}_{P4}(0)$. In this study, we suggest to choose α to be the p -value of the Test (4.1). A large p -value supports the hypothesis $H_0 : f \in F_0$ and then $\hat{f}_{P1}(0)$ is more appropriate (has larger weight) than $\hat{f}_{P2}(0)$ to estimate $f(0)$. The p -value of Test (4.1) is

$$\begin{aligned} p\text{-value} &= 2pr(Z < -|T|) \\ &= 2\Phi(-|T|), \end{aligned}$$

where Φ is the standard normal distribution function. The p -value indicates how strong H_0 is supported by the data. The properties of these proposed estimators are studied via simulation in the next section.

Simulation Study

To compare among the performances of the different estimators, a simulation study was performed. The data are simulated from densities that satisfy $f'(0) = 0$ (e.g. half normal) and from densities that do not satisfy $f'(0) = 0$ (e.g. negative exponential).

The smoothing parameter h for the different estimators is computed by using the formula $h = A \hat{\sigma} n^{-\frac{1}{5}}$, where $A = 0.933$ for $\hat{f}_k(0)$ and $\hat{f}_B(0)$; and $A = 1.206$ for the proposed estimator $\hat{f}_{P1}(0)$. Also, $h = B \hat{\theta} n^{-\frac{1}{5}}$, where $B = 3.438$ for estimator $\hat{f}_{ME}(0)$; $B = 3.122$ for estimator $\hat{f}_{EE}(0)$; and $B = 1.248$ for the proposed estimator $\hat{f}_{P2}(0)$.

All results in tables (1) and (2) depend on simulated 1000 samples of sizes $n = 50, 100, 200$. The data generated from three different families of models which are commonly

used in line transect studies (see Barabesi, 2001 and Eidous, 2009). The first model is the exponential power (EP) family (Pollock, 1978)

$$f(x) = \frac{1}{\Gamma\left(1 + \frac{1}{\beta}\right)} \exp(-x^\beta), \quad x \geq 0, \beta \geq 1,$$

with detection function $g(x) = \exp(-x^\beta)$. The hazard rate (HR) family (Hayes and Buckland, 1983)

$$f(x) = \frac{1}{\Gamma\left(1 - \frac{1}{\beta}\right)} (1 - \exp(-x^{-\beta})), \quad x \geq 0, \beta > 1,$$

with detection function $g(x) = (1 - \exp(-x^{-\beta}))$, and the beta (BE) model (Eberhardt, 1968)

$$f(x) = (1 + \beta)(1 - x)^\beta, \quad 0 \leq x < 1, \beta \geq 0,$$

with detection function $g(x) = (1 - x)^\beta$. In our simulation design, these three families were truncated at some distance w . Four models were selected from EP family with parameter values $\beta = 1.0, 1.5, 2.0, 2.5$ and corresponding truncation points given by $w = 5.0, 3.0, 2.5, 2.0$. Four models were selected from HR family with parameter values $\beta = 1.5, 2.0, 2.5, 3.0$ and corresponding truncation points given by $w = 20, 12, 8, 6$. Moreover, four models were selected from BE model with parameter values $\beta = 1.5, 2.0, 2.5, 3.0$ and $w = 1$ for all cases. The considered models cover a wide range of perpendicular distance probability density functions which vary near zero from spike to flat. The shoulder condition do not satisfy for BE model with different values of β and for EP model with $\beta = 1$. Also, despite the shoulder condition is satisfied for HR model, this model decreases sharply away from the original point (i.e. $x = 0$) when $\beta = 1.5, 2.0$. This case may be occur in practice when the visibility away from the transect line is not distinct due to - may be - fog and tall grass.

For each considered estimator and for each sample size, the relative bias

$$RB = \frac{E(\hat{f}(0)) - f(0)}{f(0)},$$

and the relative mean error

$$RME = \frac{\sqrt{MSE(\hat{f}(0))}}{f(0)},$$

are computed. The relative bias of the different estimators are presented in Table (1), while the relative mean errors are given in Table (2).

Results and Conclusions

- (1) The proposed estimator $\hat{f}_{p1}(0)$ performs well as a general estimator. Despite that this estimator is developed under the constraints $f'(0) = 0$, it performs well even for models with $f'(0) \neq 0$. Also, the results of Barabesi's estimator $\hat{f}_B(0)$ are acceptable in general.

- (2) If the set of data seem to be spike at the origin, the proposed estimator $\hat{f}_{P_2}(0)$ is a very competitor for the other existing estimators and can be recommended in this case.
- (3) The idea of combining between the proposed estimators based on testing the shoulder condition assumption seems to be success in some cases. Among the two combining estimators, the estimators $\hat{f}_{P_3}(0)$ performs better than $\hat{f}_{P_4}(0)$ in general.
- (4) It is not easy job to recommend a specific estimator –from those considered in this thesis- as a best estimator for all cases. However, we can close our comments and conclusions by saying that:
 - The classical kernel estimator $\hat{f}_k(0)$ is recommended when the model of data has a large shoulder at the origin provided that it does not decrease sharply away the origin (e.g. EP model with $\beta = 2.5$ and HR model with $\beta = 3.0$).
 - The Barabesi's estimator $\hat{f}_B(0)$ and the proposed estimator $\hat{f}_{P_1}(0)$ are recommended for data models with moderate shoulder condition at the origin (e.g. EP model with $\beta = 1.5$ and HR model with $\beta = 2.0$).
 - Eidous's estimator $\hat{f}_{EE}(0)$ and the proposed estimator $\hat{f}_{P_2}(0)$ are recommended for data models that do not have a shoulder condition at the origin (e.g. EP model with $\beta = 1.0$ and BE model with different values of β), or even for data models that have a shoulder but decreases markedly away the origin (e.g. HR model with $\beta = 1.5$). In these two cases, the proposed estimators $\hat{f}_{P_3}(0)$ and $\hat{f}_{P_4}(0)$ are also perform well.

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Table 1. The Relative Bias (RB) for $\hat{f}_k(0)$, $\hat{f}_B(0)$, $\hat{f}_{P_1}(0)$, $\hat{f}_{ME}(0)$, $\hat{f}_{EE}(0)$, $\hat{f}_{P_2}(0)$, $\hat{f}_{P_3}(0)$ and $\hat{f}_{P_4}(0)$.

β	w	n	$\hat{f}_k(0)$	$\hat{f}_B(0)$	$\hat{f}_{P_1}(0)$	$\hat{f}_{ME}(0)$	$\hat{f}_{EE}(0)$	$\hat{f}_{P_2}(0)$	$\hat{f}_{P_3}(0)$	$\hat{f}_{P_4}(0)$
Exponential power (EP) model										
		50	-0.323	-0.264	-0.309	-0.070	-0.204	-0.116	-0.247	-0.168
1.0	5.0	100	-0.290	-0.242	-0.270	-0.045	-0.163	-0.100	-0.193	-0.129
		200	-0.262	-0.225	-0.234	-0.040	-0.130	-0.085	-0.171	-0.105
		50	-0.147	-0.072	-0.099	0.046	0.062	0.057	-0.089	-0.013
1.5	3.0	100	-0.130	-0.072	-0.072	0.027	0.084	0.074	-0.060	0.011
		200	-0.109	-0.063	-0.048	0.027	0.100	0.057	-0.035	0.021
		50	-0.076	0.005	-0.004	0.064	0.200	0.124	-0.001	0.065
2.0	2.5	100	-0.060	0.003	0.013	0.049	0.207	0.117	-0.005	0.035
		200	-0.049	0.001	0.036	0.029	0.204	0.099	0.028	0.065
		50	-0.036	0.049	0.037	0.063	0.298	0.150	0.039	0.094
2.5	2.0	100	-0.032	0.033	0.055	0.038	0.286	0.123	0.067	0.106
		200	-0.025	0.024	0.074	0.024	0.253	0.098	0.049	0.070
Hazard rate (HR) model										
		50	-0.363	-0.308	-0.406	0.157	-0.275	-0.053	-0.095	-0.072
1.5	20.0	100	-0.329	-0.284	-0.355	0.183	-0.228	-0.012	-0.008	-0.004
		200	-0.275	-0.238	-0.296	0.223	-0.153	0.061	0.065	0.065
		50	-0.225	-0.157	-0.228	0.166	-0.066	0.090	-0.008	0.075
2.0	12.0	100	-0.179	-0.124	-0.181	0.180	0.009	0.135	0.030	0.104
		200	-0.135	-0.091	-0.130	0.176	0.087	0.162	0.089	0.153
		50	-0.102	-0.023	-0.074	0.138	0.142	0.176	-0.023	0.103
2.5	8.0	100	-0.067	-0.005	-0.031	0.127	0.211	0.207	0.012	0.124
		200	-0.040	0.009	0.016	0.101	0.272	0.208	0.042	0.128

		50	-0.046	0.037	0.012	0.108	0.261	0.216	0.037	0.131
3.0	6.0	100	-0.023	0.042	0.044	0.065	0.330	0.215	0.069	0.141
		200	-0.007	0.043	0.078	0.048	0.354	0.199	0.096	0.143
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Beta		(BE)								
model										
		50	-0.166	-0.093	-0.126	0.002	0.049	0.018	-0.104	-0.041
1.5	1.0	100	-0.149	-0.092	-0.095	-0.002	0.055	0.009	-0.090	-0.045
		200	-0.127	-0.083	-0.061	0.003	0.044	0.006	-0.075	-0.033
		50	-0.186	-0.115	-0.151	0.004	0.006	-0.009	-0.126	-0.061
2.0	1.0	100	-0.172	-0.117	-0.123	-0.016	0.014	-0.010	-0.113	-0.056
		200	-0.153	-0.110	-0.095	-0.007	0.004	-0.003	-0.094	-0.046
		50	-0.213	-0.144	-0.174	-0.025	-0.030	-0.028	-0.157	-0.088
2.5	1.0	100	-0.190	-0.135	-0.145	-0.018	-0.015	-0.033	-0.131	-0.070
		200	-0.176	-0.133	-0.112	-0.026	-0.016	-0.011	-0.105	-0.054
		50	-0.223	-0.155	-0.192	-0.026	-0.047	-0.033	-0.159	-0.083
3.0	1.0	100	-0.200	-0.146	-0.162	-0.019	-0.033	-0.036	-0.138	-0.075
		200	-0.180	-0.138	-0.129	-0.017	-0.025	-0.023	-0.115	-0.062
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Table 2. The Relative Mean Error (RME) for $\hat{f}_k(0)$, $\hat{f}_B(0)$, $\hat{f}_{P1}(0)$, $\hat{f}_{ME}(0)$, $\hat{f}_{EE}(0)$, $\hat{f}_{P2}(0)$, $\hat{f}_{P3}(0)$ and $\hat{f}_{P4}(0)$.

β	w	n	$\hat{f}_k(0)$	$\hat{f}_B(0)$	$\hat{f}_{P1}(0)$	$\hat{f}_{ME}(0)$	$\hat{f}_{EE}(0)$	$\hat{f}_{P2}(0)$	$\hat{f}_{P3}(0)$	$\hat{f}_{P4}(0)$
Exponential power (EP) model										
		50	0.338	0.284	0.325	0.208	0.236	0.189	0.294	0.232
1.0	5.0	100	0.299	0.255	0.280	0.160	0.188	0.150	0.245	0.186
		200	0.269	0.233	0.241	0.125	0.149	0.121	0.207	0.143
		50	0.193	0.154	0.157	0.252	0.160	0.181	0.148	0.136
1.5	3.0	100	0.160	0.123	0.113	0.187	0.137	0.155	0.132	0.142
		200	0.132	0.101	0.086	0.151	0.131	0.116	0.097	0.099
		50	0.154	0.146	0.126	0.283	0.246	0.218	0.126	0.163
2.0	2.5	100	0.119	0.109	0.097	0.208	0.233	0.182	0.097	0.120
		200	0.094	0.085	0.084	0.159	0.222	0.145	0.095	0.125
		50	0.151	0.167	0.134	0.294	0.335	0.239	0.137	0.190
2.5	2.0	100	0.117	0.125	0.116	0.224	0.309	0.187	0.129	0.165
		200	0.088	0.092	0.105	0.169	0.268	0.149	0.090	0.117
Hazard rate (HR) model										
		50	0.382	0.333	0.421	0.279	0.318	0.206	0.216	0.192
1.5	20.0	100	0.339	0.297	0.365	0.246	0.256	0.134	0.144	0.140
		200	0.283	0.249	0.303	0.258	0.180	0.120	0.120	0.120
		50	0.257	0.208	0.264	0.275	0.184	0.198	0.220	0.200
2.0	12.0	100	0.202	0.159	0.205	0.243	0.136	0.184	0.183	0.172
		200	0.150	0.114	0.147	0.216	0.131	0.180	0.193	0.192
		50	0.159	0.134	0.147	0.267	0.230	0.246	0.186	0.213
2.5	8.0	100	0.113	0.097	0.100	0.224	0.247	0.244	0.142	0.189
		200	0.077	0.072	0.067	0.171	0.289	0.230	0.108	0.168
		50	0.129	0.137	0.128	0.272	0.308	0.281	0.152	0.219
3.0	6.0	100	0.094	0.106	0.100	0.197	0.353	0.255	0.131	0.192

		200	0.076	0.091	0.106	0.167	0.365	0.222	0.122	0.170
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Beta model	(BE)									
		50	0.207	0.164	0.175	0.249	0.140	0.175	0.178	0.176
1.5	1.0	100	0.178	0.138	0.135	0.191	0.115	0.133	0.138	0.126
		200	0.148	0.115	0.092	0.152	0.089	0.100	0.117	0.107
		50	0.222	0.175	0.184	0.244	0.129	0.167	0.187	0.174
2.0	1.0	100	0.196	0.154	0.150	0.186	0.100	0.123	0.151	0.130
		200	0.168	0.131	0.116	0.139	0.077	0.103	0.130	0.110
		50	0.243	0.192	0.205	0.240	0.126	0.167	0.211	0.182
2.5	1.0	100	0.209	0.165	0.167	0.179	0.097	0.128	0.173	0.144
		200	0.189	0.152	0.130	0.142	0.081	0.106	0.146	0.119
		50	0.249	0.197	0.218	0.223	0.133	0.165	0.210	0.176
3.0	1.0	100	0.219	0.175	0.182	0.178	0.105	0.137	0.179	0.142
		200	0.192	0.154	0.143	0.133	0.082	0.101	0.153	0.118
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CREDIT CHAINS AND MORTGAGE CRISES

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Abstract:

I examine a production economy with a financial sector that contains multiple layers of credit. Such layers are designed to constitute credit chains which are inclusive of a simple mortgage market. The focus is on the nature and contagion properties of credit chains in an economy where the financial sector plays a real allocative role and agents have a nontrivial choice of whether to default on mortgages or not. Multiple equilibria with different rates of default are observed, due to the presence of strategic complementarities. Default can trigger a financial crisis as well as constrain the purchases of factors of production, thus leading to potentially serious effects on real activity.

Key Words: Credit chains, mortgages, default

Resumen

Examiné una economía de producción con un sector financiero que contiene múltiples capas de crédito. Tales capas están diseñadas para constituir cadenas de crédito las cuales son incluyentes de un mercado hipotecario sencillo. La atención se centra en la naturaleza y las propiedades de contagio de las cadenas de crédito en una economía donde el sector financiero juega un rol real de asignación de recursos y los agentes tienen una elección no trivial ya sea por defecto de las hipotecas o no. Equilibrios múltiples con diferentes tasas de incumplimiento son observados, debido a la presencia de estrategias complementarias. El incumplimiento puede desencadenar una crisis financiera tan buena como limitar las compras de factores de producción, entonces conduce efectos potencialmente serios en la actividad real.

Introduction

In this paper, I build a dynamic stochastic general equilibrium model of credit chains in a closed-economy payments system that shares the spirit of Freeman (1996, 2001), Hernández-Verme (2004) and Freeman and Hernández-Verme (2008.) I must point out outright that I do not aim at replicating the facts before and after the subprime mortgage crisis. My purpose is humbler: to illustrate the presence and functioning of credit chains in the overall structure of a financial system where spatial separation is nontrivial. The following innovations in my model are of the utmost importance: the presence of a simple mortgage market, the presence of a strategic group of banks who are local monopolies in offering deposits and mortgage loans; the double role of the lending sector, which is also the productive sector in this economy; the presence of a shock that sizes down (or up) the value of the real state at the time when the mortgages are repaid, leading to a nontrivial choice of whether to default on mortgages or not.

There are three groups of strategic agents that interact in a payments system in this model economy: lenders, borrowers and banks. Moreover, one can classify borrowers in two classes in equilibrium: borrowers who default on their debt and borrowers who repay their debt. My main

underlying hypothesis is that, even in the absence of a house bubble, the structure of the financial system itself makes it vulnerable to default, systemic risk and downturns in economic activity. Moreover, the analysis of welfare in equilibrium will be shown to defy conventional wisdom in terms of who wins and who loses as a result of a crisis in this economy.

The contributions of this paper with respect to the previous literature can be listed as follows:

- The presence of a shock that alters the resources available to borrowers⁶⁶.
- Borrowers choosing endogenously whether to default or not.
- The presence of banks that are local monopolies and offer both deposit and mortgage contracts.
- The introduction of a very simple mortgage market in a model of the payment system
- The linkage between production possibilities and default on debt
- The presence of strategic complementarities that may lead to the presence of multiple equilibria

In this model economy, default reduces the resources available to purchase labor, subsequently reducing output. There is always a positive rate of default in equilibrium, whether it is unique or not. Moreover, universal default and universal repayment cannot obtain in equilibrium due to the nature of the shock that continuously hits this economy and the signaling to lenders by borrowers, respectively. The equilibrium interest rates on deposits, IOUs and loans display the potential for the existence of two equilibria: one with a low rate of default and the other with a high rate of default. However, the model so far has not produced any criteria for equilibrium selection yet⁶⁷. I must also point out that, against standard intuition, the bank obtains positive profits only when the equilibrium rates of default are sufficiently high; my interpretation of this result is that banks are risk lovers in equilibrium.

In this model, young borrowers formulate a contingent plan in light of the realization of the shock that they will experience the following period. This works through the choice of a cut-off value from the distribution of the shock, such that realizations below the cut-off will lead to defaulting while realizations above the cut-off will lead to repayment. A crisis in this model takes the form of an innovation in such cut-off value of the shock. The main results of the analysis are as follows:

1. A crisis reduces total output in this economy by reducing the resources available to purchase labor.
2. A crisis also reduces the aggregate welfare of borrowers. However, this effect can be misleading, since the borrowers who default experience welfare gains, while the “honest” borrowers who choose to repay their debt are made worse-off. Thus, contrary to conventional wisdom, the result shows that the borrowers who default do not suffer from this shock and that the ones who are in the need of help, probably from government agencies, are the “honest” borrowers.
3. The lenders in this economy (equivalent to the general public who holds deposits on banks) experience significant welfare gains as a result of a crisis. This, then, is another sector that is not in need of government assistance.
4. A crisis increases the bank’s income but reduces its costs, thus increasing the bank’s profits in equilibrium. This result seems to go against conventional wisdom, but remember that there are no investment banks in this model nor mortgage backed securities. This is consistent with the fact that commercial banks seem to be doing reasonable well in light of the subprime mortgage crisis.

Finally, I would like to mention that my initial intentions included the examination of alternative Liquidity Saving Mechanisms (LSM) and alternative rules for the settlement of debt as well, but, due to my time constraint, this has not been incorporated into the model yet.

⁶⁶ This is an improvement on Freeman and Hernandez-Verme (2008,) that used a location-specific utility shock.

⁶⁷ This is mostly due to my time constraint, but I will be working on this subject next.

The Environment

Consider a model closed economy consists of one central settlement location and $I > 2$ triplets of outer islands, indexed by $i = 1, 2, \dots, I$. Time is discrete and indexed by $t = 1, 2, \dots$. All strategic agents are overlapping generations that live for 2-periods, and population is constant. Throughout the paper, I assume that all contracts are enforceable when on the Central Island, but not on the outer islands. There is a fiat currency that circulates in this economy. For simplicity, I will label this currency as dollars.

In this model economy, each date has two parts: morning and afternoon, and transactions/actions take place sequentially in each of them. All strategic agents must travel to the central island in the morning of their old age, where contracts can be enforced. On the central island, clearing and settlement of debt will take place through a third party, which I will interchangeably call throughout the centralized settlement institution or monetary authority.

The Main Actors

There are three groups of strategic agents in each triplet i . There is a continuum of borrowers with unit mass on the first island of the triplet, which I will call Borrowers i , and a continuum of Lenders also with a unit mass on the second island of the triplet, which I will call Lenders i . Finally, there is a monopolistic bank on the third island of the triplet, which I will call Bank i .

There is also a nonstrategic agent on the central island that I will call the monetary authority, which is also the central settlement institution. Each bank must create a reserve account with the monetary authority.

The Goods

There are five goods in this economy. First, Lenders i have an endowment good when young. The size of this endowment is $x > 0, \forall i$, but this good is island-specific, with a price of p_t^i dollars per good at date t . Second, Lenders i can produce a final good when old. This good is also island-specific, and its price at date t is θ_t^i dollars per good.

In the third place, young Borrowers i have an endowment good in the amount $y \in (0, 1)$. This good is also island-specific, and it is attachable as down-payment for a house in Banks i in the following way: y is the fraction of the value of a house that Borrowers i can put as a down-payment when young. This good is not otherwise traded.

Fourthly, Bank i is endowed with $z > 0$ of an agent- and triplet-specific good. Bank i can only use this good to partially finance mortgage loans to young Borrowers i at the price μ_t^i . This good is not traded otherwise.

The last “good” in this economy is labor. Young borrowers in island i are endowed with one unit of non storable labor. Labor is homogeneous across agents and islands, and it is traded for the nominal wage w_t in the afternoon of date t .

The Assets

There are six different assets in this economy. In the first place, we have the debt (IOUs) issued by Borrowers i to Lenders $i + 1$, so that the former can purchase the endowment good of the latter. The associated promised real gross interest rate r_{t+1}^{i+1} is set on triplet $i + 1$ at date t by young lenders. This loan must be repaid next period using fiat money.

Secondly, there is a fixed stock I of identical houses, such that there is one house per each Borrower. In each triplet, there is a continuum of houses with unit mass that is located in the

Borrowers' island. The price of a house in triplet i is q_t^i dollars at date t . Houses do not depreciate, other than for a shock that we will discuss in the next section.

Third, young Lenders i can accumulate physical capital by investing when young. This investment technology will yield as much capital at $t+1$ as it was invested at t . Capital is island-specific and it depreciates completely after production, and I will denote it by K_{t+1}^i . In the fourth place, there is fiat money issued by the monetary authority, and M_t denotes the nominal money supply at date t . Fiat money is used to purchase labor, to pay mortgages in full, to settle IOUs and to purchase the Lender i 's final good. The return on real money balances between dates t and $t+1$ is given by (w_t/w_{t+1}) .

The fifth asset consists of mortgage contracts issued by Bank i to Borrowers i . The promised real gross interest rate set at date t by the bank is ρ_{t+1}^i , and mortgages must be repaid in full with fiat money the next period. Finally, young Lenders i can also make deposits in the monopolistic Bank i in the amount d_t^i at date t . The promised real gross interest rate on deposits set by the bank at date t is R_{t+1}^i , which is paid at date $t+1$.

Uncertainty

In this economy, all Borrowers i are ex ante identical. However, they expect a shock to be realized at the beginning of their old age. This shock will affect the amount of real state held by old borrowers in that it can reduce or increase the value of individual real state, but leaves the aggregate real state unchanged. I will denote the realization of the shock to household j in triplet i at date t by $\lambda_t^{i,j}$. However, I will drop the subscript and supra-scripts in the remainder of this section in order to simplify both notation and explanation.

I let λ denote the shock, which represents the fraction of the house that is left to borrowers in the morning when old. This shock is i.i.d.-distributed over borrower households, triplets and time. I use $g(\lambda)$ to denote the stationary p.d.f. of the shock, while $G(\lambda)$ denotes the associated c.d.f. The support set of this shock is given by $[\lambda_L, \lambda_H]$, where I assume that $\lambda_L \in [0,1)$ and $\lambda_H > 1$. Henceforth,

for tractability, I will assume λ has a uniform distribution. Thus, $g(\lambda) = \frac{1}{\lambda_H - \lambda_L}$ and

$G(\lambda) = \frac{\lambda - \lambda_L}{\lambda_H - \lambda_L}$. The distribution of the shock is public information, but not its individual realization, which will be known only to the individual borrower.

The variable λ is a multiplicative shock that alters the resources available to old borrowers. The old borrower must pay $\rho_{t+1}^i \cdot q_t^i \cdot (1-y)$ dollars to the bank early in the morning of date $t+1$ to repay her mortgage in full, but her resources are scaled down (or up) to $\lambda_{t+1} \cdot \rho_{t+1}^i \cdot q_t^i \cdot (1-y)$. Before she sells the house, she must repair it, incurring in a cost of $(1-\lambda_{t+1}) \cdot q_{t+1}^i$ dollars $\forall \lambda_{t+1} \leq 1$, to bring the

house back to its original condition⁶⁸. Next, she sells the house for q_{t+1}^i , obtaining the net profit $\lambda_{t+1} \cdot q_{t+1}^i$. In case the borrower defaults, the bank seizes the house and it must make the same repairs before selling it.

Young borrowers anticipate this, but not the particular realization of λ_{t+1} , and they form a contingent plan in which they choose a cut-off value $\tilde{\lambda}$ of the shock from the support of the distribution, such that $\tilde{\lambda} \in [\lambda_L, \lambda_H]$. In particular, borrower households will repay their mortgage when the realization of the shock is such that $\tilde{\lambda} \leq \lambda_{t+1} \leq \lambda_H$, while they will default when $\lambda_L \leq \lambda_{t+1} < \tilde{\lambda}$ obtains. As we will see later, a choice of repaying or defaulting on a mortgage is, at the same time, a choice of repaying or defaulting on IOU: all these transactions must take place on the central island and if the borrower chooses to repay her IOU, it must also repay her mortgage.

Default is also costly to borrowers in utility terms. Old borrowers may consume (use) their houses when old in the afternoon: $h_{t+1}^i = \{0, 1\}, \forall i, t > 0$. $h_{t+1}^i = 1$ only when the mortgage has been repaid in full, but $h_{t+1}^i = 0$ if they default on the mortgage, and they must forego the utility of the house they bought the previous date.

The stock of houses left in a particular triplet after the shocks are realized and before the houses are repaired is given by $\int_{\lambda_L}^{\lambda_H} \lambda \cdot g(\lambda) \cdot d\lambda = (\lambda_H + \lambda_L) / 2 \leq (\geq) 1$. After the repairs, the stock of houses per triplet goes back to $\int_0^1 (1) dj = 1$.

One can also calculate the probability of default in a particular island by using the Law of Large Numbers. Let π_{t+1}^i denote the probability of default on a particular triplet. Then, $\pi_{t+1}^i = \int_{\lambda_L}^{\tilde{\lambda}} g(\lambda) \cdot d\lambda = G(\tilde{\lambda}) = \tilde{\lambda} / (\lambda_H - \lambda_L)$. The reader may notice that I keep the supra-script i on the rate of default, since there is a potential for multiple equilibria in this economy. The promised interest rates will be reduced by the factor $(1 - \pi_{t+1}^i)$ in equilibrium.

Endowments of the Agents in Triplet i

Lenders. Lenders are endowed with $x > 0$ units each of their endowment good when young, which is island-specific and it non storable. They are also endowed with an investment technology that allows them to accumulate physical capital when young. This technology is island-specific and not transferable, and so is the capital.

When old, lenders are endowed with a technology that allows them to produce an island-specific final good, for which they need to utilize physical capital and labor to produce the specific final good i when old, for which they need physical capital and labor. This technology is island-specific and not transferable. Lenders have no other endowment when old.

Borrowers. Young borrowers are endowed with $y \in (0, 1)$, where y represents the fraction of the value of a house they can put as down payment. This endowment good is island-specific and

⁶⁸ Notice that when $\lambda_{t+1} \in (1, \lambda_H]$, the borrower is entitled to a profit in the order of $(\lambda_{t+1} - 1) \cdot q_{t+1}^i$ dollars.

only attachable as a down-payment for a house. In addition, they are endowed with a technology to issue IOUs to Lenders from island $i + 1$, which is island-specific and not transferable as well. Finally, also when young, borrowers are endowed with one unit of non storable labor, which is homogeneous across agents and borrowers. Borrowers have no endowment when old.

The Bank. When young, the bank is endowed with $z > 0$ units of an endowment good, which will be used to partially finance mortgages. The young bank has a monopoly on the following two activities in triplet i : first, they can offer deposit contracts from young lenders, and, second, they can package mortgage contracts to be offered to young borrowers. These last activities are island-specific and non transferable. The bank has no endowments when old.

The Initial Old. At the initial date, $t=0$, there is a generation of initial old agents in each triplet i with the same size as the regular generation born at date $t \geq 0$. They hold the initial supplies of assets in this economy. Thus, the initial old borrowers hold the endowment of houses in each triplet, given by $I/I = 1$. The initial money supply (the monetary base) is distributed equally among triplets in the amount of $m_0 \equiv (M_0/I)$ dollars. The money supply in a particular triplet is distributed proportionately to initial old lenders and the initial old bank. Notice that the latter implies I endogenous initial conditions, summarized by $\{m_0/p_0^i\}_{i=1}^I$. Finally, the initial stock of capital in triplet i is given by K_0^i , which is distributed equally among initial old lenders. The latter implies I exogenous initial conditions, which are summarized by $\{K_0^i\}_{i=1}^I$.

Monetary Policy and Aggregate Money Supply

The monetary policy in this model economy is very simple. For now, I assume that supply of high power money is constant, such that $M_t = M_0, \forall t \geq 0$. In addition, the I banks in this economy must hold domestic currency reserves with the central bank, where $\phi \in [0,1]$ denotes the fraction of deposits that each bank must hold each period. Moreover, in this model economy, banks give loans to young borrowers, who use them to purchase houses. Thus, the aggregate money supply in public hands at date t is given by $M_t = M_0 - \sum_{i=1}^I \phi \cdot p_t^i \cdot d_t^i$ dollars. Notice that there is no secondary money creation role played by banks, since those funds are already allocated into the purchase of houses and do not circulate into the economy again.

Markets for Houses and Factors of Production

The characterization of the market for houses is very simple. There are I triplet-specific markets for houses in which young borrowers buy a house each either from old borrowers or the bank. The depiction of the markets for factors of production is very simple as well. In the first place, there is an integrated market for labor: labor is homogeneous across triplets, and young workers can work on any triplet they choose. The price of labor is the nominal wage at date t , given by w_t , and the relevant measure of the real wage is given by (w_t/p_t^{i+1}) . On the other hand, there are I island-specific markets for capital, since only $K_t^i > 0$ can be used by old lenders i to produce their island-specific final good at date t .

Preferences and Actions

In this section, I discuss the preferences and potential choices of each of the three types of strategic agents, as well as the problem they each solve. The focus is on a typical generation born at triplet i at date t . Recall that the composition of each generation is constant over time: there are lenders, borrowers and one bank which will interact not only with each other, but also with either agent from other triplets as well as with agents from other generations.

The Lender from Triplet i

All lenders from triplet i are ex-ante identical. Each lender wishes to consume the final good i that they produce when old in the amount $l_{2,t+1}^i$ in the afternoon. When young, she allocates her endowment good as follows. First, early in the morning, she sells part of her endowment to young borrowers from island $i-1$ in exchange for IOUs in the amount of s_t^i dollars. Second, still in the morning, she deposits d_t^i units of her endowment in Bank i . Finally, before the end of the morning, she invests the remainder of her endowment into physical capital, such that K_{t+1}^i goods invested at date t will yield K_{t+1}^i units of capital in the afternoon at date $t+1$. K_{t+1}^i will be used at date $t+1$, together with labor, to produce the final good. The details of the lender's time line are presented in Figure 1 below.

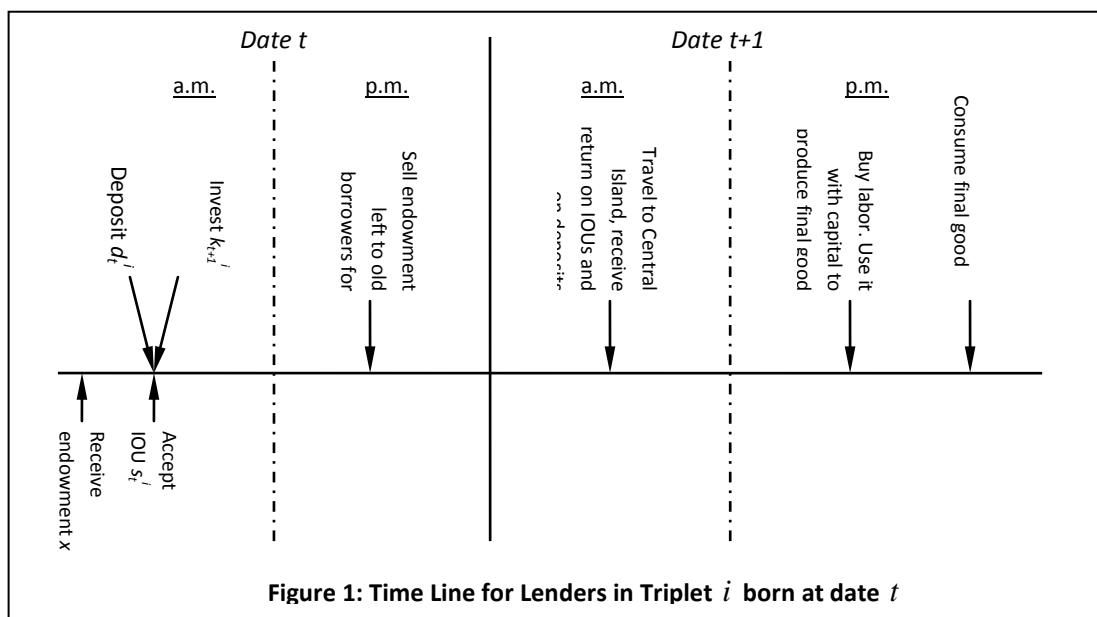


Figure 1: Time Line for Lenders in Triplet i born at date t

In the morning of the next period, all lenders must travel to the central island in order to get the repayment of their IOUs from borrowers and the return of their deposits from the bank. Next, in the afternoon, each old lender uses the return on her deposits and the payment of the IOUs she holds to purchase labor. She also sells part of the final good she will produce to old borrowers from island $i-1/2$ in exchange for \hat{m}_{t+1}^i dollars, and uses these proceeds to purchase labor as well. Next, before the end of the afternoon, the old lender produces her triplet-specific final good using the technology $f_{t+1}^i = F(K_{t+1}^i, L_{t+1}^i) = (K_{t+1}^i)^\alpha \cdot (L_{t+1}^i)^{1-\alpha}$, $\alpha \in (0,1)$, and consume part of it in the amount $l_{2,t+1}^i$.

The preferences of a lender from island i born at date t are given by

$$u\left(l_{2,t+1}^i\right) = \ln\left(l_{2,t+1}^i\right) \quad (1),$$

while her budget constraints are given by

$$x = \left(\frac{s_t^i}{p_t^i}\right) + d_t^i + K_{t+1}^i, \quad (2a)$$

$$(1 - \pi_{t+1}^i) \cdot p_{t+1}^i \cdot \left[R_{t+1}^i \cdot d_t^i + r_{t+1}^i \cdot \left(\frac{s_t^i}{p_t^i}\right) \right] + \widehat{m}_{t+1}^i = w_{t+1} \cdot L_{t+1}, \quad (2b)$$

$$l_{2,t+1}^i + \frac{\widehat{m}_{t+1}^i}{\theta_{t+1}^i} = f_{t+1}^i = \left(K_{t+1}^i\right)^\alpha \cdot \left(L_{t+1}\right)^{1-\alpha}. \quad (2c)$$

Thus, the problem of a young lender from triplet i is given by

$$\underset{\frac{s_t^i}{p_t^i}, d_t^i, \frac{\widehat{m}_{t+1}^i}{\theta_{t+1}^i}}{\text{Max}} \ln \left[\left(K_{t+1}^i\right)^\alpha \cdot \left(L_{t+1}\right)^{1-\alpha} - \frac{\widehat{m}_{t+1}^i}{\theta_{t+1}^i} \right], \quad (3a)$$

subject to:

$$K_{t+1}^i = x - \frac{s_t^i}{p_t^i} - d_t^i \quad (3b)$$

$$L_{t+1} = (1 - \pi_{t+1}^i) \cdot \left(\frac{p_{t+1}^i}{w_{t+1}}\right) \cdot \left[r_{t+1}^i \cdot \left(\frac{s_t^i}{p_t^i}\right) + R_{t+1}^i \cdot d_t^i \right] + \left(\frac{\widehat{m}_{t+1}^i}{\theta_{t+1}^i}\right) \cdot \left(\frac{\theta_{t+1}^i}{w_{t+1}}\right), \quad (3c)$$

taking π_{t+1}^i and all prices as given. Notice that the proceeds from deposits and IOUs are scaled down by the rate of default π_{t+1}^i . As a result, the necessary first order conditions for this problem, assuming an interior solution, are summarized by

$$\left(\frac{\alpha}{1-\alpha}\right) \cdot \left(\frac{L_{t+1}}{K_{t+1}^i}\right) = (1 - \pi_{t+1}^i) \cdot r_{t+1}^i \cdot \left(\frac{p_{t+1}^i}{w_{t+1}}\right), \quad (4a)$$

$$\left(\frac{\alpha}{1-\alpha}\right) \cdot \left(\frac{L_{t+1}}{K_{t+1}^i}\right) = (1 - \pi_{t+1}^i) \cdot R_{t+1}^i \cdot \left(\frac{p_{t+1}^i}{w_{t+1}}\right), \quad (4b)$$

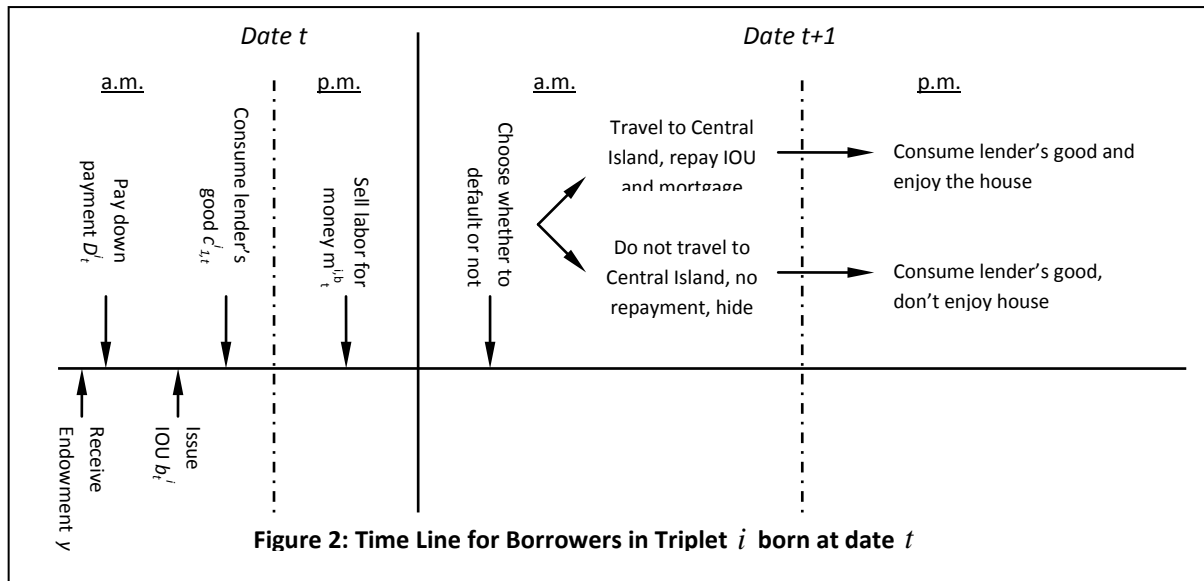
$$(1 - \alpha) \cdot \left(\frac{K_{t+1}^i}{L_{t+1}}\right)^\alpha = \frac{w_{t+1}}{\theta_{t+1}^i}. \quad (4c)$$

Equivalently, (4c) can be rewritten as $MPL_{t+1}^i = \left(w_{t+1} / \theta_{t+1}^i\right)$, which illustrates the fact that labor paid according to its marginal product. Notice as well that (4a) together with (4b) imply that there is no arbitrage between IOUs and deposits, and, thus, the following condition must hold for an interior solution:

$$r_{t+1}^i = R_{t+1}^i = \left(\frac{\alpha}{1-\alpha}\right) \cdot \left(\frac{L_{t+1}}{K_{t+1}^i}\right) \cdot \left[\frac{\left(w_{t+1} / p_{t+1}^i\right)}{\left(1 - \pi_{t+1}^i\right)}\right] \quad (4d)$$

The Borrower j from Triplet i

All borrowers $j \in [0,1]$ in island i are identical in every respect but for the realization of the shock that will hit them in the following date. The realizations of this shock are borrower and triplet-specific and its distribution is common knowledge. Each borrower knows that the shock will hit them next period, but they do not know what its realization will be at the moment when they are making their choices. Then, all borrowers must formulate choose a contingent plan that will be adjusted depending on the realization of the shock. In addition, I assume that borrowers do not have a bequest motive, so they must sell their houses before they die. The details of the borrower's time line are presented in the figure below.



Young borrowers from island i wish to consume $c_{1,t}^i$ units of Lenders $i+1$'s endowment good when young in the morning of date t . Since they have nothing of value to offer to lenders at this time, they issue an IOU of value $b_t^i = p_t^{i+1} \cdot c_{1,t}^i$ dollars to be re-paid using fiat money in the morning of $t+1$ on the Central Island, with the promised interest rate r_{t+1}^{i+1} . At this time, they also sign a mortgage contract with Bank i , where this Bank requires a promised real gross interest rate ρ_{t+1}^i . Obviously, houses are an indivisible good, and they can buy only one house. The mortgage contract requires young borrowers from island i to make the down payment D_t^i for a house when young in the morning, in the amount $D_t^i = q_t^i \cdot y$ dollars. Finally, at this point of time, they also choose the cut-off value $\tilde{\lambda}$ from the distribution of shocks, in the manner described in sub-section 2.4. In the afternoon, young borrowers sell their labor. They work for either old lenders or old banks on any island in exchange for the nominal wage w_t . By this point in time, the choices of $c_{1,t}^i$, (b_t^i / p_t^{i+1}) , D_t^i and the supply of labor are already inelastic.

First thing in the morning of the following period, the borrower j from triplet i is in her old age, and she learns her individual realization of the shock, $\lambda_{t+1}^{i,j}$. Regardless of the particular

realization of the shock and of whether the mortgage will be repaid or not, the house must be rebuilt before it is sold again later in the morning, incurring in a cost of $(1-\lambda_{t+1}^{i,k}) \cdot q_{t+1}^i$ dollars. Next, based upon this realization, the borrower decides whether or not to pay the remainder of their mortgage. Recall that all repayments must be made on the Central Island, using fiat money. Thus, if a particular borrower chooses not to repay her mortgage, she cannot repay her IOUs either, since she would get caught once she is on the Central Island. Moreover, if the borrower defaults, she cannot enjoy the house $(h_{t+1}^{i,j}=0)$ or sell it later, since the house goes to the bank. In this respect, then, the choice of whether or not to default is also a choice of enjoying their house or not when old. Later, in the afternoon, the borrower would like to purchase the final good produced by old lenders in island $i+I/2$ and consume it, implying a cost of $\theta^{i+I/2} \cdot c_{2,t+1}^i$ dollars. She must pay for this good at the time of the transaction using fiat money, and she can do this regardless of her choice of whether or not to default, since nobody knows her in island $i+I/2$, nor they care about her having repaid all her debt or not.

Let me discuss briefly how borrowers implement their contingent plans. Each old borrower j learns her individual realization of the shock, $\lambda_{t+1}^{i,j}$, and she compares it against her chosen cut-off value $\tilde{\lambda}$. On the one hand, if $\lambda_{t+1}^{i,j} < \tilde{\lambda}$, the borrower decides that is not in her best interest to repay her mortgage and IOUs. Instead, she can take her money balances with her and run away to island $i+I/2$ to purchase the old lender's final good, but $h_{t+1}^i = 0$ and her house goes back to the bank, which has to rebuild it before selling it. On the other hand, if $\lambda_{t+1}^{i,j} \geq \tilde{\lambda}$, the borrower repays her mortgage in full for $\rho_{t+1}^i \cdot q_t^i \cdot (1-y)$ dollars, and repays her IOU for $p_{t+1}^{i+1} \cdot r_{t+1}^{i+1} \cdot (b_t^i / p_t^{i+1})$ dollars. Next, she enjoys the house $(h_{t+1}^i = 1)$ and she rebuilds whatever was destroyed by the shock $(1-\lambda_{t+1}^{i,k}) \cdot q_{t+1}^i$ dollars⁶⁹, then selling it for q_{t+1}^i . Finally, in the afternoon, she travels to island $i+I/2$ to purchase the old lender's final good.

The lifetime utility of a borrower is given by

$$u(c_{1,t}^i, c_{2,t+1}^i, h_{t+1}^i, \lambda_{t+1}^{i,j}) = \ln(c_{1,t}^i) + \ln(c_{2,t+1}^i) + h_{t+1}^i, \quad (5)$$

while the budget constraints faced by a young borrower are:

$$c_{1,t}^i = \left(\frac{b_t^i}{p_t^{i+1}} \right), \quad (6a)$$

$$D_t^i = q_t^i \cdot y \quad (6b)$$

$$\bar{m}_t^i = w_t = w_t \cdot L_t + w_t \cdot a_t \quad (6c)$$

For starters, an old borrower who chooses not to default (i.e., when $\lambda_{t+1}^{i,j} \geq \tilde{\lambda}$ obtains) will face the following constraints

⁶⁹ When $\lambda_{t+1}^{i,j} > 1$, the borrower will experience an equity gain instead in the amount of $(\lambda_{t+1}^{i,j} - 1) \cdot q_{t+1}^i$.

$$\widehat{c}_{2,t+1}^{i,j} = \left(\frac{w_t}{\theta^{i+1/2}} \right) + \lambda_{t+1}^{i,j} \cdot \left(\frac{q_{t+1}^i}{\theta^{i+1/2}} \right) - r_{t+1}^{i+1} \cdot \left(\frac{p_{t+1}^i}{\theta^{i+1/2}} \right) \cdot \left(\frac{b_t^i}{p_t^{i+1}} \right) - \rho_{t+1}^i \cdot \left(\frac{q_t^i}{\theta^{i+1/2}} \right) \cdot (1-y), \quad (7a)$$

$$h_{t+1}^{i,j} = 1, \quad (7b).$$

Secondly, an old borrower who chooses to default (i.e., when $\lambda_{t+1}^{i,j} < \tilde{\lambda}$ obtains) faces the following two constraints instead

$$\widetilde{c}_{2,t+1}^{i,j} = \frac{w_t}{\theta^{i+1/2}}, \quad (8a)$$

$$h_{t+1}^{i,j} = 0. \quad (8b)$$

Thus, the problem that Borrower j from triplet i must solve is

$$\text{Max}_{c_{1,t}^i, \widetilde{c}_{2,t+1}^i, \widehat{c}_{2,t+1}^i, \tilde{\lambda}} \ln(c_{1,t}^i) + \int_{\lambda_L}^{\tilde{\lambda}} \ln(\widetilde{c}_{2,t+1}^i) \cdot d\lambda + \int_{\tilde{\lambda}}^{\lambda_H} [\ln(\widehat{c}_{2,t+1}^i) + 1] \cdot d\lambda \quad (9a)$$

$$\text{s.t.} \quad (6a), (7a), (7b), (8a), (8b),$$

$$\lambda_L \leq \tilde{\lambda} \leq \lambda_H, \quad (9b)$$

and taking all prices as given. After integrating by parts and using change of variable, we can rewrite this problem as the maximization, by choosing (b_t^i / p_t^{i+1}) and $\tilde{\lambda}$, of the following objective function⁷⁰

$$u(c_{1,t}^i, \widetilde{c}_{2,t+1}^i, \widehat{c}_{2,t+1}^i, \tilde{\lambda}) = \ln\left(\frac{b_t^i}{p_t^{i+1}}\right) + (\tilde{\lambda} - \lambda_L) \cdot \left(\frac{w_t}{\theta^{i+1/2}}\right) + \ln[\widehat{c}_{2,t+1}^i(\lambda_H)] \cdot A(\lambda_H) - \ln[\widehat{c}_{2,t+1}^i(\tilde{\lambda})] \cdot A(\tilde{\lambda}), \quad (10a)$$

where:

$$\widehat{c}_{2,t+1}^i(\lambda_H) \equiv \left(\frac{w_t}{\theta^{i+1/2}} \right) + \lambda_H \cdot \left(\frac{q_{t+1}^i}{\theta^{i+1/2}} \right) - \rho_{t+1}^i \cdot (1-y) \cdot \left(\frac{q_t^i}{\theta^{i+1/2}} \right) - r_{t+1}^{i+1} \cdot \left(\frac{p_{t+1}^i}{\theta^{i+1/2}} \right) \cdot \left(\frac{b_t^i}{p_t^{i+1}} \right), \quad (10b)$$

$$\widehat{c}_{2,t+1}^i(\tilde{\lambda}) \equiv \left(\frac{w_t}{\theta^{i+1/2}} \right) + \tilde{\lambda} \cdot \left(\frac{q_{t+1}^i}{\theta^{i+1/2}} \right) - \rho_{t+1}^i \cdot (1-y) \cdot \left(\frac{q_t^i}{\theta^{i+1/2}} \right) - r_{t+1}^{i+1} \cdot \left(\frac{p_{t+1}^i}{\theta^{i+1/2}} \right) \cdot \left(\frac{b_t^i}{p_t^{i+1}} \right), \quad (10c)$$

$$A(\spadesuit) \equiv \left\{ \spadesuit + \frac{w_t}{q_{t+1}^i} - \rho_{t+1}^i \cdot \left[\frac{q_t^i \cdot (1-y)}{q_{t+1}^i} \right] - r_{t+1}^{i+1} \cdot \left(\frac{p_{t+1}^i}{q_{t+1}^i} \right) \cdot \left(\frac{b_t^i}{p_t^{i+1}} \right) \right\}. \quad (10d)$$

Of course, the condition (9b) must also hold. A couple of observations will become useful later on. First, $\widehat{c}_{2,t+1}^i$ and $A(\cdot)$ are increasing in λ . Second, $A/\widehat{c}_2 = \theta^{i+1/2}/q_{t+1}^i$ is positive. Next, I proceed to discuss and evaluate the first order conditions for this problem.

⁷⁰ For details, see the Technical Appendix.

The first order condition with respect to $\left(b_t^i/p_t^{i+1}\right)$ is given by

$$\frac{1}{\left(b_t^i/p_t^{i+1}\right)} - \frac{r_{t+1}^{i+1} \cdot p_{t+1}^i}{q_{t+1}^i} \cdot \left\{ \ln \left[\tilde{c}_{2,t+1}^i \left(\lambda_H \right) \right] - \ln \left[\tilde{c}_{2,t+1}^i \left(\tilde{\lambda} \right) \right] \right\} \geq 0. \quad (11a)$$

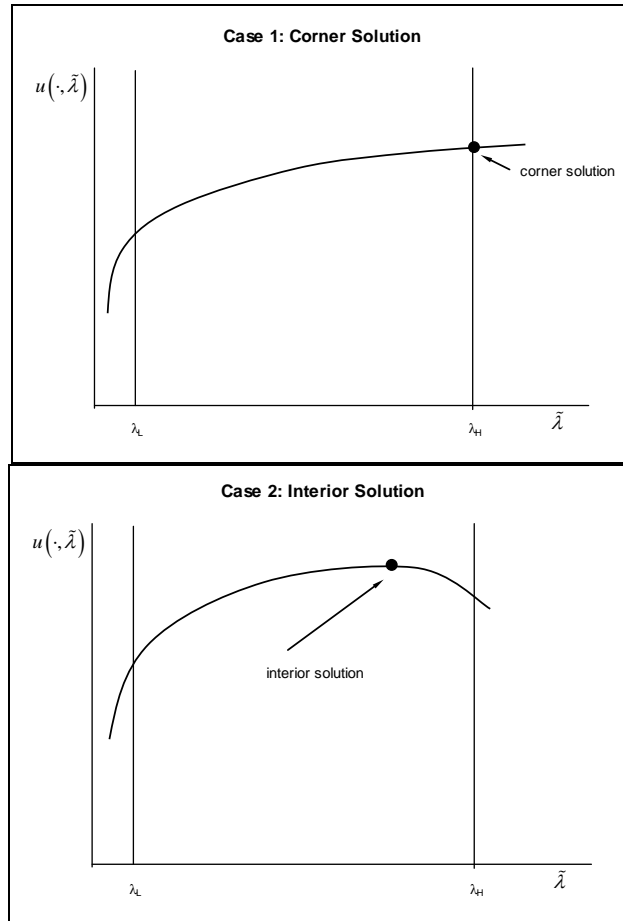
To discuss the properties of the borrower's solution for $\left(b_t^i/p_t^{i+1}\right)$, we must evaluate different possibilities using (11a). I use a simple fixed point technique⁷¹. The results show that $(b/p)^* > 0$ does exist and it is unique, with some qualifications. First, $(b/p)^*$ does not exist for $\tilde{\lambda} = \lambda_L$. Second, $\exists \lambda_M \leq \lambda_H \mid (b/p)^* = \left(w_t/\theta_{t+1}\right)$.

The first order condition with respect to $\tilde{\lambda}$ is given by

$$\tilde{c}_{2,t+1}^i - 1 - \ln \left[\tilde{c}_{2,t+1}^i \left(\tilde{\lambda} \right) \right]. \quad (11b)$$

The expression in (11b) requires additional examination. First, notice that $\tilde{c}_{2,t+1}^i = \left(w_t/\theta_{t+1}^{i+1/2}\right)$ is independent of $\tilde{\lambda}$ from the standpoint of the borrower and, thus, we can treat it as fixed for now. Second, the expression in (11b) is positive when $\tilde{\lambda} = \lambda_L$, implying that the latter is not a solution. Third, the expression in (11b) decreases with $\tilde{\lambda}$. Two cases may arise, based on the particular value that λ_H may take: when λ_H is sufficiently low, $\tilde{\lambda}^* = \lambda_H$ is a corner solution, while when λ_H is large enough, $\tilde{\lambda}^* < \lambda_H$ is an interior solution. The two cases are depicted in the diagrams below.

⁷¹ For details, see the Technical Appendix.



I now proceed to evaluate the expression in (11b) for different potential values of $\tilde{\lambda} \in [\lambda_L, \lambda_H]$.

Universal Repayment. When $\tilde{\lambda} = \lambda_L$, the borrower would choose to always repay. Obviously, it must be the case that $\tilde{c}_{2,t+1}^i(\tilde{\lambda} = \lambda_L) > (w_t / \theta^{i+1/2})$. The latter implies that the following condition must hold

$$\lambda_L > \bar{\lambda}_L \equiv \frac{\rho_{t+1}^i \cdot (1-y) \cdot q_t^i}{q_{t+1}^i} + \left(\frac{r_{t+1}^i \cdot p_{t+1}^i}{q_{t+1}^i} \right) \cdot \left[\frac{b_t^i}{p_t^{i+1}}(\lambda_L) \right]^* > 0 \quad (12a)$$

for $\tilde{\lambda} = \lambda_L$ to be a solution to this problem. Obviously, this is not the case when $\lambda_L \in [0, \bar{\lambda}_L]$, implying that $\tilde{\lambda} = \lambda_L$ cannot be a solution when the potential negative effects of the shock are significantly large. As an example, when borrowers know that their house can be totally destroyed by the shock, some positive mass of them will choose not to repay. The latter is consistent with my previous examination of (11b) that states that $\tilde{\lambda} = \lambda_L$ is not a solution.

Universal Default. Suppose now that $\tilde{\lambda} = \lambda_H$. In this case, the borrower chooses never to repay, and it must be the case that $\tilde{c}_{2,t+1}^i(\tilde{\lambda} = \lambda_H) < (w_t / \theta^{i+1/2})$. The preceding inequality leads to the following condition

$$\lambda_H < \bar{\lambda}_H \equiv \frac{\rho_{t+1}^i \cdot q_t^i \cdot (1-y)}{q_{t+1}^i} + r_{t+1}^i \cdot \left(\frac{p_{t+1}^i}{q_{t+1}^i} \right) \cdot \left[\frac{b_t^i}{p_t^{i+1}} (\lambda_H) \right]^* \quad (12b)$$

which must hold for $\tilde{\lambda} = \lambda_H$ to be a solution. Condition (12b) means that, for values of λ_H that are sufficiently low, $\tilde{\lambda}^* = \lambda_H$ is a solution, which is illustrated in Case 1. However, for values of λ_H that are high enough, i.e. for values such that $\lambda_H \geq \bar{\lambda}_H$, $\tilde{\lambda} = \lambda_H$ is not the solution, but instead $\lambda_L < \tilde{\lambda} < \lambda_H$ is the interior solution for this problem. The latter can be explained by the fact when borrowers know that the equity in their houses can increase significantly, a positive mass of them will choose to repay in order to rip-off these benefits.

Some Default. Finally, consider again the case of the interior solution such that $\tilde{\lambda}^* \in (\lambda_L, \lambda_H)$. In this case, $\bar{c}_{2,t+1}^i(\tilde{\lambda}) = \bar{c}_{2,t+1}^i$ must hold, implying that $\tilde{\lambda}^*$ must satisfy the following condition

$$\tilde{\lambda}^* = \frac{\rho_{t+1}^i \cdot q_t^i \cdot (1-y)}{q_{t+1}^i} + r_{t+1}^i \cdot \left(\frac{p_{t+1}^i}{q_{t+1}^i} \right) \cdot \left[\frac{b_t^i}{p_t^{i+1}} (\tilde{\lambda}^*) \right]. \quad (12c)$$

The Bank from Triplet *i*

The Bank in triplet *i* is a monopoly and she starts with zero reserves when young. She packages and offers deposit contracts to young lenders and mortgage contracts to young borrowers. In addition, the bank must hold currency reserves from *t* to *t+1*: a fraction $\phi \in (0,1)$ of the dollar-value of the young lenders’ deposits. Let χ_t^i denote the amount of dollar-reserves held in the reserves account in the monetary authority. Figure 3 below illustrates the details of the bank’s time line.

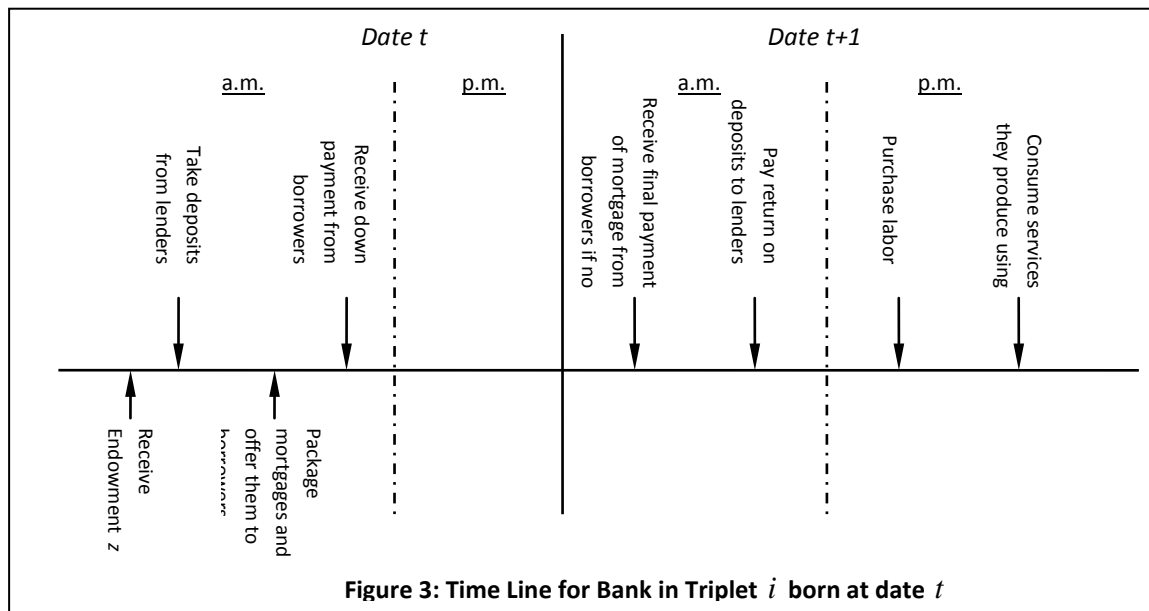


Figure 3: Time Line for Bank in Triplet *i* born at date *t*

Deposit contracts. The Bank offers deposits contracts to young lenders born on triplet *i*. Each young lender must deposit $p_t^i \cdot d_t^i$ dollars early in the morning of date *t*, and keep them in the

bank until the afternoon of date $t + 1$. In turn, the Bank promises the real gross interest rate R_{t+1}^i per unit of deposits, to be paid in the afternoon of date $t + 1$. The Bank has the monopoly in triplet i in offering these deposit contracts. The return on deposits will be paid to the lenders once they are on the central island, at the same time the mortgages are repaid.

Mortgage contracts. Young lenders would like buy a house worth q_t^i in the morning of date t . They aim at borrowing from the Bank for this purpose. The mortgage contract specifies the following: 1) the young lender must put a down payment of $D_t^i = y \cdot q_t^i$ dollars. The bank lends the remainder $\Lambda_t = (1 - y) \cdot q_t^i$ dollars and it purchases the house. The lenders must repay $\rho_{t+1}^i \cdot \Lambda_t = \rho_{t+1}^i \cdot (1 - y) \cdot q_t^i$ dollars in the morning of date $t + 1$, after which they own the house and they can sell it after repairing it at the price q_{t+1}^i . In the case of default, the Bank i appropriates the house instead, and she can sell it after making the repairs also at the price q_{t+1}^i . Of course, ρ_{t+1}^i denotes the real gross interest rate on loans set by the Bank. It is worth pointing out that the Bank has the monopoly in pooling the resources available, given by her endowment good and the fraction $(1 - \phi)$ of the deposits in her vaults, and this must also be feasible. While the mortgage contract is signed at the Bank, all repayments must take place on the Central Island in the morning of date $t + 1$.

With respect to her preferences, the Bank wishes to consume a_{t+1}^i units of services when old in the afternoon. Such services are produced only by the Bank, one-to-one, from labor purchased. Obviously, $(w_{t+1}/p_{t+1}^i) \cdot a_{t+1}^i$ denotes Bank i 's real cost of purchasing $a_{t+1}^i > 0$ units of services. Her utility function takes the following form:

$$u(a_{t+1}^i) = \ln(a_{t+1}^i), \quad (13)$$

while the Bank's budget constraints are given by

$$\mu_t^i \cdot z + p_t^i \cdot d_t^i = q_t^i \cdot (1 - y) + \chi_t^i \quad (14a)$$

$$\chi_t^i = \phi \cdot p_t^i \cdot d_t^i. \quad (14b)$$

Combining (14a) and (14b), I obtain

$$a_{t+1}^i = \frac{(\tilde{\lambda}^2 - \lambda_L^2) \cdot q_{t+1}^i}{2 \cdot w_{t+1}} + (\lambda_H - \tilde{\lambda}) \cdot \left[\frac{\rho_{t+1}^i \cdot q_t^i \cdot (1 - y)}{w_{t+1}} \right] - R_{t+1}^i \cdot \left[\frac{p_{t+1}^i \cdot d_t^i}{w_{t+1}} \right] + \left(\frac{\chi_t^i}{w_{t+1}} \right). \quad (14c)$$

I now can express the Bank's problem as a constrained profit-maximization

$$\begin{aligned} & \mathbf{Max}_{R_{t+1}^i, \rho_{t+1}^i} \ln(a_{t+1}^i) \\ & \text{s.t.} \quad (14c), \end{aligned}$$

taking $\tilde{\lambda}, \lambda_L, \lambda_H$ and all other prices as given. The first order conditions of this problem with

respect to R_{t+1}^i and ρ_{t+1}^i are, respectively,

$$-\frac{p_t^i \cdot d_t^i}{a_{t+1}^i \cdot w_{t+1}} < 0 \quad (15a)$$

$$\left(\lambda_H - \tilde{\lambda}\right) \cdot \left[\frac{q_t^i \cdot (1-y)}{a_{t+1}^i \cdot w_{t+1}}\right] > 0. \quad (15b)$$

On the one hand, the condition in (15a) implies a left-corner solution for R_{t+1}^i , i.e. the Bank will pay the lowest interest rate on deposits that lenders would be willing to accept, which I will denote by \hat{R}_{t+1}^i . In this case, we can obtain \hat{R}_{t+1}^i from equation (4d), such that

$$\hat{R}_{t+1}^i(\tilde{\lambda}) = \hat{r}_{t+1}^i(\tilde{\lambda}) = \frac{\alpha \cdot L_{t+1} \cdot w_{t+1}}{(1-\alpha) \cdot K_{t+1}^i \cdot p_{t+1}^i} \cdot \left(\frac{\lambda_H - \lambda_L}{\lambda_H - \tilde{\lambda}}\right), \quad (16a)$$

where it is apparent that $\hat{R}_{t+1}^i(\tilde{\lambda})$ is increasing in $\tilde{\lambda}$, from the Bank's standpoint.

On the other hand, the condition in (15b) indicates that the Bank will charge the maximum possible interest rate on loans that would be acceptable by borrowers who will not default. This interest rate $\hat{\rho}_{t+1}^i$ will be such that $\tilde{c}_{2,t+1}^i(\tilde{\lambda}) = \tilde{c}_{2,t+1}^i = \left(w_{t+1} / \theta_{t+1}^{i+1/2}\right)$ obtains. Using equation (10c), one can solve for $\hat{\rho}_{t+1}^i$ and obtain the following

$$\hat{\rho}_{t+1}^i(\tilde{\lambda}) = \frac{\tilde{\lambda} \cdot q_{t+1}^i}{q_t^i \cdot (1-y)} - \frac{\hat{R}_{t+1}^i(\tilde{\lambda}) \cdot p_{t+1}^i}{q_t^i \cdot (1-y)} \cdot \frac{b_t^i}{p_t^{i+1}}. \quad (16b)$$

However, it is unclear whether the equilibrium interest rate on loans increases with $\tilde{\lambda}$ or not. To summarize, equations (16a) and (16b) represent the Bank's profit-maximizing choices.

General Equilibrium

In this section, I summarize the conditions that must hold in a general equilibrium. I proceed by blocks. First, I present the four conditions related to the financial and asset markets. The market for IOUs must clear at date t , which happens when

$$\frac{s_t^i}{p_t^i} = \frac{b_t^{i-1}}{p_t^i}(\tilde{\lambda}) \quad (17a)$$

for all t and i . Next, the market for mortgages clears at t when

$$\mu_t^i \cdot z + (1-\phi) \cdot p_t^i \cdot d_t^i = q_t^i \cdot (1-y), \quad (17b)$$

while the markets for money and for reserves clear, respectively, when

$$M_t = M_0 - \sum_{i=1}^I p_t^i \cdot \phi \cdot d_t^i = I \cdot w_t \quad (17c)$$

$$\phi \cdot p_t^i \cdot d_t^i = \chi_t. \quad (17d)$$

Secondly, I present the markets for factors of production. The market for labor at date t clears when

$$I \cdot L_t + \sum_{i=1}^I a_t^i = I \quad (18)$$

holds, and, due to the particular structural characteristics of capital creation, the market for physical capital always clears.

In the third place, I present the conditions for the different markets for goods. The market for the lender's endowment good clears when

$$x = K_{t+1}^i + \frac{b^{i-1}}{p_t}(\tilde{\lambda}) + d_t^i \quad (19a)$$

is satisfied, while the market for the lender's final good clears when

$$\begin{aligned} \left(K_{t+1}^i\right)^\alpha \left(L_{t+1}\right)^{1-\alpha} = l_{2,t+1}^i + \left(\frac{w_{t+1}}{\theta^{i+1/2}}\right) \\ + \left(\theta^{i+1/2}\right)^{-1} \int_{\tilde{\lambda}}^{\lambda_H} \left[\lambda_{t+1}^i \cdot q_{t+1}^i - \hat{\rho}_{t+1}^i(\tilde{\lambda}) \cdot q_t^i \cdot (1-y) - \hat{R}_{t+1}^i(\lambda) \cdot \frac{b^{i-1}}{p_{t+1}}(\tilde{\lambda}) \right] \cdot d\lambda \end{aligned} \quad (19b)$$

Now, I turn to discuss the properties of some of the key variables in the model in a symmetric equilibrium.

A Symmetric General Equilibrium

In this model economy, the structure at heart has been designed so that the agents that belong to a particular type but were born in different triplets face the same problem and the same conditions but for the individual realizations of the shock that affects old borrowers. It comes naturally, then, to pay attention to a symmetric equilibrium.

A symmetric equilibrium is defined as one in which all triplet-specific variables x^i are equal to their counterparts from all other triplets x^j , $j \neq i$. For example, $\tilde{\lambda}_{t+1}^i = \tilde{\lambda}_{t+1}^j$, $\forall i$, and so on, with the exception of the realizations of individual-specific shocks. This exercise will allow me to point out the potential for strategic complementarities that underlies this economy.

The reader will notice that the main equilibrium quantities and interest rates are a function of $\tilde{\lambda}$ in equilibrium. In what follows, I describe the properties of the gains/losses of the different agents in equilibrium when there is an innovation in $\tilde{\lambda}$.

Labor Purchases by Old Lenders and Total Output

In equilibrium, I obtain that there is no closed-form solution for the labor purchases by old lenders $L_{t+1}(\tilde{\lambda})$. Moreover, $L_{t+1}(\tilde{\lambda})$ is properly defined iff $K_{t+1} < \alpha \cdot x$ ⁷². The following equation defines implicitly the labor purchases by old lenders

$$-\left[\frac{\alpha \cdot x - K_{t+1}}{(1-\alpha) \cdot K_{t+1}}\right] = \frac{1}{L_{t+1}(\tilde{\lambda})} + \left[\frac{q_{t+1}}{2\theta \cdot (\lambda_H - \lambda_L)}\right] \cdot \frac{(\lambda_H - \tilde{\lambda})^2}{(1-\alpha) \cdot K_{t+1}} \cdot \left[L_{t+1}(\tilde{\lambda})\right]^\alpha. \quad (20a)$$

Equation (21a) illustrates the fact that the labor purchases by old lenders are a function of $\tilde{\lambda}$, but also of K_{t+1} . However, the latter is inelastic and independent of $\tilde{\lambda}$, since it was chosen before the realization of the latter. Interestingly, $L_{t+1}(\tilde{\lambda})$ is a key indicator of the welfare of old lenders, since it

⁷² $L_{t+1}(\tilde{\lambda})$ is undefined and discontinuous when $K_{t+1} = \alpha \cdot x$, since $\lim_{K_{t+1} \rightarrow (\alpha \cdot x)^-} = \infty$ and $\lim_{K_{t+1} \rightarrow (\alpha \cdot x)^+} = -\infty$.

represents their ability to produce their final good, for a given K_{t+1} . The following proposition illustrates the changes in the old lenders' welfare when facing an innovation in $\tilde{\lambda}$.

Proposition 1 An innovation in $\tilde{\lambda}$ reduces the ability of old lenders of purchasing labor by reducing their resources available. The latter also reduces their ability of producing their final good, thus reducing its supply in equilibrium.

Proof: After differentiating (20a) with respect to $\tilde{\lambda}$ and an extensive rearrangement of terms, one obtains

$$\frac{dL}{d\tilde{\lambda}} = -\frac{2 \cdot q_{t+1} \cdot L^{\alpha+1} \cdot (\lambda_H - \tilde{\lambda})}{(1-\alpha) \cdot \left[2\theta \cdot (\lambda_H - \lambda_L) \cdot K^\alpha + q_{t+1} \cdot L^\alpha \right]} < 0, \quad (20b)$$

which indicates that the lender's purchases of labor fall in the face of an innovation of $\tilde{\lambda}$.

Second, the total production of the final good $Y_{t+1} = K^\alpha \cdot L^{1-\alpha}$ depends on both capital and labor purchases. At the time when an innovation of $\tilde{\lambda}$ is observed, K is inelastic, and only L will respond to this change. Thus, differentiating Y_{t+1} with respect to $\tilde{\lambda}$ yields

$$\frac{dY_{t+1}}{d\tilde{\lambda}} = (1-\alpha) \cdot K^\alpha \cdot L^{-\alpha} \cdot \frac{dL}{d\tilde{\lambda}} < 0. \quad (20c)$$

Of course, the latter implies a reduction of total output in the presence of an innovation of the cut-off value of the shock.

Q.E.D.

The Welfare of Old Borrowers

In a symmetric general equilibrium, the following basic conditions illustrate important properties that are consistent with the contingent plan of action that borrowers formulated when young:

$$\hat{c}_{2,t+1}(\tilde{\lambda}) = \tilde{c}_{2,t+1} = \frac{w_{t+1}}{\theta_{t+1}} = \frac{(1-\alpha) \cdot K^\alpha}{L^\alpha} > 0, \quad (21a)$$

$$\hat{c}_{2,t+1}(\lambda_{t+1}) - \hat{c}_{2,t+1}(\tilde{\lambda}) = \frac{q_{t+1} \cdot (\lambda_{t+1} - \tilde{\lambda})}{\theta_{t+1}}, \quad (21b)$$

$$\hat{c}_{2,t+1}(\lambda_{t+1}) = \frac{w_{t+1}}{\theta_{t+1}} + \frac{(\lambda_{t+1} - \tilde{\lambda}) \cdot q_{t+1}}{\theta_{t+1}} = \frac{(1-\alpha) \cdot K^\alpha}{L^\alpha} + \frac{(\lambda_{t+1} - \tilde{\lambda}) \cdot q_{t+1}}{\theta_{t+1}} > 0. \quad (21c)$$

First, equation (21a) indicates that the marginal old borrower –who experiences the realization $\lambda_{t+1} = \tilde{\lambda}$ – is indifferent between defaulting and repaying her debt. Second, condition (21b) illustrates two facts. On the one hand, an old borrower who experiences realizations such that $\lambda_{t+1} \in [\lambda_L, \tilde{\lambda})$ will be worse-off than defaulting if she chooses to repay her debt since $\hat{c}_{2,t+1}(\lambda_{t+1}) < (w_{t+1}/\theta_{t+1})$. On the other hand, an old borrower who experiences realizations such that $\lambda_{t+1} \in (\tilde{\lambda}, \lambda_H]$ will find it in her best interest to repay her debt, since $\hat{c}_{2,t+1}(\lambda_{t+1}) > (w_{t+1}/\theta_{t+1})$. Equation (21c) describes the consumption of an old borrower who chooses to repay her debt. It is thus apparent that when

$\lambda_{t+1} \in [\lambda_L, \tilde{\lambda})$ obtains, the old borrower will choose to default on her debt and she will consume $\tilde{c}_{2,t+1} = (w_{t+1}/\theta_{t+1})$, while when $\lambda_{t+1} \in (\tilde{\lambda}, \lambda_H]$ obtains, the borrower will choose to repay her debt and she will consume $\hat{c}_{2,t+1}(\lambda_{t+1}) = (w_{t+1}/\theta_{t+1}) + [q_{t+1} \cdot (\lambda_{t+1} - \tilde{\lambda})/\theta_{t+1}] > \tilde{c}_{2,t+1}$.

I now turn to the analysis of the effects of an innovation of $\tilde{\lambda}$, which are described in the following proposition.

Proposition 2 An innovation in $\tilde{\lambda}$ affects the welfare of the two groups of old borrowers differently: it makes the borrowers who chose to default on their debt better-off, while the borrowers who chose to repay their debt worse-off. However, the group of old borrowers as a whole are made worse-off by the increase in $\tilde{\lambda}$. Moreover, the number of borrowers in the first group increases, while the number of borrowers in the second group decreases.

Proof: I start with the consumption of borrowers who choose to default in equilibrium. By differentiating (21a) with respect to $\tilde{\lambda}$, one obtains

$$\frac{d\tilde{c}_{2,t+1}}{d\tilde{\lambda}} = -\frac{\alpha \cdot (1-\alpha) \cdot K^{\alpha}}{L^{\alpha+1}} \cdot \frac{dL}{d\tilde{\lambda}} > 0. \quad (21d)$$

Equation (21d) indicates that old borrowers who choose to default are made better-off by an innovation in $\tilde{\lambda}$. The fraction of borrowers who default, given by $(\tilde{\lambda} - \lambda_L)/(\lambda_H - \lambda_L)$, increases with $\tilde{\lambda}$, which is consistent with the increase observed in $\tilde{c}_{2,t+1}$.

Regarding the consumption of borrowers who choose to repay their debt, one must differentiate equation (21c) with respect to $\tilde{\lambda}$. By doing so, one obtains

$$\frac{d\hat{c}_{2,t+1}(\lambda_{t+1})}{d\tilde{\lambda}} = \frac{2 \cdot \theta_{t+1} \cdot q_{t+1} \cdot K^{\alpha} [(\alpha-1) \cdot \lambda_H - \alpha \cdot \tilde{\lambda} + \lambda_L] - (q_{t+1})^2 \cdot L^{\alpha}}{\theta_{t+1} \cdot [2 \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot K^{\alpha} + q_{t+1} \cdot L^{\alpha}]} < 0. \quad (21e)$$

Interestingly, equation (21e) indicates that an innovation in $\tilde{\lambda}$ causes the old borrowers who chose to repay their debt to be worse-off. Finally, the fraction of borrowers who choose to repay their debt, given by $(\lambda_H - \tilde{\lambda})/(\lambda_H - \lambda_L)$, decreases with $\tilde{\lambda}$. The latter is consistent with the reduction in $\hat{c}_{2,t+1}$. These two effects continue until $\hat{c}_{2,t+1}(\tilde{\lambda}') = (w_{t+1}/\theta_{t+1})'$, where $\tilde{\lambda}'$ is the new cut-off value of the shock.

I now turn to analyze the aggregate welfare of borrowers, given by $(\hat{m}_{t+1}/\theta_{t+1})$ in the equation below.

$$\frac{\hat{m}_{t+1}}{\theta_{t+1}} = \frac{w_{t+1}}{\theta_{t+1}} + \left(\frac{q_{t+1}}{\theta_{t+1}}\right) \cdot \int_{\tilde{\lambda}}^{\lambda_H} \frac{(\lambda_{t+1} - \tilde{\lambda})}{(\lambda_H - \lambda_L)} \cdot d\lambda_{t+1}. \quad (21f)$$

After some non-trivial effort, I was able to show that

$$\frac{d(\hat{m}_{t+1}/\theta_{t+1})}{d\tilde{\lambda}} = q_{t+1} \cdot (\lambda_H - \tilde{\lambda}) \left\{ \frac{[2 \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot K^{\alpha}] \cdot (\alpha-1) - q_{t+1} \cdot L^{\alpha}}{\theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot [2 \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot K^{\alpha} + q_{t+1} \cdot L^{\alpha}]} \right\} < 0, \quad (21g)$$

which indicates that the aggregate welfare of old borrowers is reduced by an innovation in $\tilde{\lambda}$.

Q.E.D.

Interestingly, Proposition 3 illustrates the fact that, in the time of a mortgage crisis, the borrowers who choose to default experience welfare gains, while the “honest” borrowers will be made worse-off. Moreover, the losses experienced by the “honest” borrowers dominate, making the borrowers as a group worse-off. This result is the more appealing when one confronts the conventional wisdom around the subprime mortgage crisis, where a case is being made to attempt to improve the conditions faced by the borrowers who have been forced to default on their mortgages. It would appear that, instead, the case shall be made to help those who are trying to repair their mortgages, not the ones who defaulted.

The Welfare of Old Lenders

Now I am in a position to analyze the welfare of the old lenders in equilibrium. A lender's welfare depends on her consumption of the final good she produces, $l_{2,t+1}$. In turn, following equation (3a), it transpires that the lenders' consumption depends on both the amount produced of the good and the consumption of the old borrowers. The proposition below presents some very provoking results that involve the lenders' welfare.

Proposition 3 The old lenders experience welfare gains, after a mortgage crisis in the form of an innovation in $\tilde{\lambda}$ has obtained.

Proof: After imposing the general equilibrium conditions in equation (3a) and differentiating with respect to $\tilde{\lambda}$, it transpires that

$$\frac{dl_{2,t+1}}{d\tilde{\lambda}} = \frac{2 \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot (\lambda_H - \tilde{\lambda}) \cdot K^\alpha \cdot (1 - \alpha - L) + (q_{t+1})^2 \cdot (\lambda_H - \tilde{\lambda}) \cdot L^\alpha}{\theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot [2 \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L) \cdot K^\alpha + q_{t+1} \cdot L^\alpha]} > 0. \quad (22a)$$

The former equation indicates that an innovation in $\tilde{\lambda}$ increases the old lenders' consumption in equilibrium. The latter, of course, will result in a welfare gain for these agents.

Q.E.D.

The expression in (22a) indicates that, contrary to what one expect, the lenders' welfare improves in the time of a crisis originated by an innovations in the cut-off value of the shock. Given the circumstances, one would tend to look first at the reduction of output as one factor that would undermine the lenders' welfare. However, the reduction in the borrowers' welfare dominates this effect. Thus, the old lenders are made better-off at the expense of the old borrowers'.

The Welfare of the Bank

The welfare of the different individual banks is directly related to their profits, which take the form of purchases of labor when old, a_{t+1} . After imposing the general equilibrium conditions on (14c), one obtains the following expression

$$a_{t+1} = \kappa(\tilde{\lambda}) - \xi(\tilde{\lambda}), \quad (23a)$$

Where $\kappa(\tilde{\lambda})$ represents the bank's income/revenue function and $\xi(\tilde{\lambda})$ denotes the bank's cost function. I proceed now by analyzing each of these functions separately, at first.

Properties of the Bank's Revenue Function. The revenue function in a general equilibrium is given by

$$\kappa(\tilde{\lambda}) \equiv \frac{\tilde{\lambda}^2 \cdot q_{t+1}}{2 \cdot w_{t+1}} + \frac{(\lambda_H - \tilde{\lambda}) \cdot \hat{p}_{t+1} \cdot q_t \cdot (1 - y)}{w_{t+1}} + \frac{\chi_t}{w_{t+1}} - \frac{\lambda_L^2 \cdot q_{t+1}}{2 \cdot w_{t+1}} \quad (23b)$$

The evaluation of the revenue function at the extreme values of the distribution of $\tilde{\lambda}$ provides interesting insight. I start by evaluating the revenue function at $\tilde{\lambda} = 0 \leq \lambda_L$

$$\kappa(0) = \frac{\phi \cdot p_t \cdot (x - K)}{w_{t+1}} - \frac{\phi \cdot p_t \cdot (b_t/p_t)}{w_{t+1}} - \frac{\lambda_L^2 \cdot q_{t+1}}{w_{t+1}} - \frac{\alpha \cdot (L/K) \cdot (b_t/p_t) \cdot (\lambda_H - \lambda_L)}{(1 - \alpha)} < 0. \quad (23c)$$

Thus, the bank would receive negative revenue for values of $\tilde{\lambda}$ that are sufficiently low. However, $\kappa(\tilde{\lambda})$ increases as $\tilde{\lambda}$ continues to increase, as one can deduce from the following expression

$$\frac{d\kappa(\tilde{\lambda})}{d\tilde{\lambda}} = \frac{\hat{R}_{t+1} \cdot p_{t+1} \cdot (b_t/p_t)}{w_{t+1}} \cdot \left[\frac{2 \cdot (\lambda_H - \tilde{\lambda}) + 1}{(\lambda_H - \tilde{\lambda})} \right] - \frac{q_{t+1}}{w_{t+1}} > 0. \quad (23d)$$

It is easy to figure out from (23d) that $\left. \frac{d\kappa(\tilde{\lambda})}{d\tilde{\lambda}} \right|_{\tilde{\lambda}=0} > 0$ although $\lim_{\tilde{\lambda} \rightarrow \lambda_H} \frac{d\kappa(\tilde{\lambda})}{d\tilde{\lambda}} = \infty$. In the limit, it transpires that $\kappa(\lambda_H) = \left[(\lambda_H^2 - \lambda_L^2) \cdot q_{t+1} \right] / 2 \cdot w_{t+1} + \chi_t / w_{t+1} > 0$ holds. In summary, the bank's revenue function is an increasing and convex function of $\tilde{\lambda}$ which happens to be negative for low enough values of its argument.

Properties of the Bank's Cost Function. The bank's cost function in a general equilibrium has the following form

$$\xi(\tilde{\lambda}) = \frac{\hat{R}_{t+1} \cdot p_{t+1} \cdot d_t}{w_{t+1}} - \frac{\hat{R}_{t+1} \cdot p_{t+1} \cdot (x - K)}{w_{t+1}} - \frac{\hat{R}_{t+1} \cdot p_{t+1} \cdot (b_t/p_t)}{w_{t+1}} > 0. \quad (24a)$$

Equation (24a) indicates that there are two forces at play in the cost function: the effect that increases the interest rate on deposits has as $\tilde{\lambda}$ increases, and the effect that reduces the deposits under the same conditions. The latter is apparent from⁷³

$$\frac{d\xi(\tilde{\lambda})}{d\tilde{\lambda}} = \left(\frac{d\hat{R}_{t+1}}{d\tilde{\lambda}} \right) \cdot p_{t+1} \cdot \left[x - K - (b_t/p_t) \right] - \left[\frac{d(b_t/p_t)}{d\tilde{\lambda}} \right] \cdot \hat{R}_{t+1} \cdot p_{t+1}. \quad (24b)$$

It is the case that, in equilibrium, the costs are increasing in $\tilde{\lambda}$ for values of $\tilde{\lambda}$ that are low enough, while they decrease for higher values of $\tilde{\lambda}$. Moreover, $d^2\xi(\tilde{\lambda})/d\tilde{\lambda}^2 < 0$ holds, indicating that costs are a strictly concave function of the cut-off value of the shock.

Properties of the Bank's Profits. The diagram below will help us understand the behavior of a_{t+1} by illustrating together the behavior of revenue and costs as a function of $\tilde{\lambda}$.

⁷³ See the following sections for details on \hat{R}_{t+1} , \hat{p}_{t+1} and (b_t/p_t) .

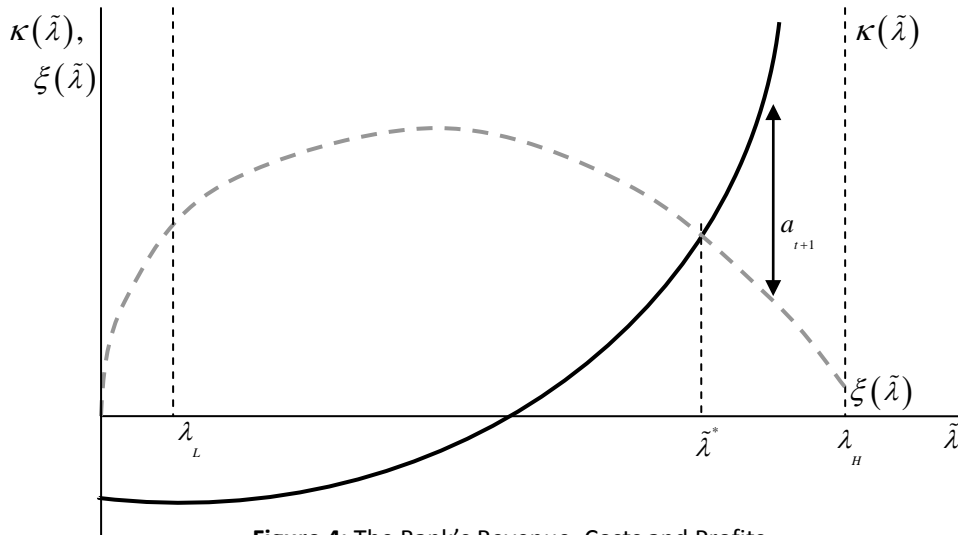


Figure 4: The Bank's Revenue, Costs and Profits

Now, I restrict my attention to the analysis of the equilibria that have economic meaning, as described in the following proposition.

Proposition 4 Equilibria can only exist in the range $\tilde{\lambda} \in [\tilde{\lambda}^*, \lambda_H]$, where profits are positive.

Proof: In this model, the bank uses her profits to purchase labor. Since one cannot purchase negative amounts of labor, and because the bank has no supply of labor to offer when old⁷⁴, we can rule out equilibria where $\tilde{\lambda} \in [\lambda_L, \tilde{\lambda}^*)$ and $a_{t+1} < 0$. Thus, equilibria will exist only for allocations where $\tilde{\lambda} \in [\tilde{\lambda}^*, \lambda_H]$ and $a_{t+1} \geq 0$ hold.

Q.E.D.

In this model, even though banks are local monopolies, they are vulnerable to the presence of allocations where operation is not economically viable. Contrary to conventional wisdom, the banks will prefer allocations associated with higher rates of default and risk, since only there can they expect to make a profit and remain open to the public. Allocations where $\tilde{\lambda} \in [\lambda_L, \tilde{\lambda}^*)$ can also be interpreted as equilibria in which financial autarky is present and the market for mortgages does not operate. In the latter case, though, the market for IOUs could still be operative. One can then say that, in this model economy, banks are slaves to risk and conscious risk-takers in equilibrium. However, there is a double edge to this statement, since in the limit, when $\tilde{\lambda} = \lambda_H$, there is universal default and banks could not subsist either since deposits would be close to zero.

The Amount Issued of IOUs

The real value of the IOUs issued and its properties will indicate the direction of the strategic interaction present in equilibrium in this economy. I proceed by first combining equations (11a), (16a) and (16b) and imposing an interior solution for both (b_t/p_t) and $\tilde{\lambda}$. Then, one obtains the following

expression, which defines the function $\frac{b}{p_t}(\tilde{\lambda})$ implicitly:

⁷⁴ One could think as well of the possibility of endowing old banks with labor when old, but this seems to complicate matters greatly without the corresponding gain in insight.

$$\left[\frac{b}{p_t}(\tilde{\lambda}) \right]^{-1} = \frac{\hat{R}_{t+1}(\tilde{\lambda}) \cdot p_{t+1}}{q_{t+1}} \cdot \ln \left\{ w_{t+1} + \lambda_H \cdot q_{t+1} - \hat{\rho}_{t+1}(\tilde{\lambda}) \cdot q_t \cdot (1-y) - \hat{R}_{t+1}(\tilde{\lambda}) \cdot p_{t+1} \cdot \left[\frac{b}{p_t}(\tilde{\lambda}) \right] \right\} \quad (25a)$$

$$- \frac{\hat{R}_{t+1}(\tilde{\lambda}) \cdot p_{t+1}}{q_{t+1}} \cdot \ln \left\{ w_{t+1} + \tilde{\lambda} \cdot q_{t+1} - \hat{\rho}_{t+1}(\tilde{\lambda}) \cdot q_t \cdot (1-y) - \hat{R}_{t+1}(\tilde{\lambda}) \cdot p_{t+1} \cdot \left[\frac{b}{p_t}(\tilde{\lambda}) \right] \right\}$$

Equation (21) a second order, nonlinear equation in $\frac{b}{p_t}(\tilde{\lambda})$, in which $\tilde{\lambda}$ also appears in the denominator of \hat{R}_{t+1} . On the first hand, if, in equilibrium, it is observed that $\left(\frac{b}{p_t}\right)$ increases with $\tilde{\lambda}$, it will indicate the presence of strategic complementarities. On the other hand, if $\left(\frac{b}{p_t}\right)$ decreases with $\tilde{\lambda}$, strategic substitutability dominates in equilibrium. Given the complex nature of the expression in (25a), it is not clear at first sight whether the IOUs issued are increasing or decreasing in $\tilde{\lambda}$. The following proposition illustrates the results.

Proposition 5 $\left(\frac{b}{p_t}\right)$ is increasing in the cut-off value of the shock, $\tilde{\lambda}$, over the interval (λ_L, λ_M) , where λ_M is such that $\frac{b}{p_t}(\lambda_M) = \frac{w_{t+1}}{\theta_{t+1}}$.

Proof:

a) Boundaries for the domain of $\left(\frac{b}{p_t}\right)$. First, $\frac{b}{p_t}(\lambda_L)$ does not exist⁷⁵. Second, $\left(\frac{b}{p_t}\right) = \left(w_{t+1}/\theta_{t+1}\right)$ does not obtain in equilibrium. Two reasons explain the latter. First, the lenders' investment into capital must be strictly positive, and second, lenders will realize that borrowers will not have any resources left to repay their mortgages, thus defaulting both on mortgages and the IOUs.

b) After excruciating pain and suffering, I was able to find that⁷⁶

$$\frac{d\left(\frac{b}{p_t}\right)}{d\tilde{\lambda}} = \frac{A_1(\tilde{\lambda}) + A_2(\tilde{\lambda})}{A_3(\tilde{\lambda})} \quad (25b)$$

where I have assumed that $dL/d\tilde{\lambda} = 0$, to fix ideas. Moreover, one observes that $d\left(\frac{b}{p_t}\right)/d\tilde{\lambda} > 0$ everywhere but on the interval $[\bar{\lambda}_1, \bar{\lambda}_2]$, where $1 < \bar{\lambda}_1, \bar{\lambda}_2 < \lambda_H$ and $d\left(\frac{b}{p_t}\right)/d\tilde{\lambda} < 0$. Thus, there is an interval $[\bar{\lambda}_1, \bar{\lambda}_3]$, for $\bar{\lambda}_2 < \bar{\lambda}_3 < \lambda_H$, where more than one equilibria can exist, in the sense that the same value $\left(\frac{b}{p_t}\right) > 0$ transpires for more than one value of $\tilde{\lambda}$. Graphical analysis indicates that at most three equilibria can obtain.

Q.E.D.

The previous result is very interesting. It implies that, in general, when $\tilde{\lambda}$ is higher, the young borrowers know that there will be a higher rate of default in the following date, and thus choose to

⁷⁵ See details in section 2 of the Technical Appendix.

⁷⁶ See the Technical Appendix for details on this proof.

borrow more, since they will very likely choose not repay it. Thus, the equilibrium in this model economy has the potential for strategic complementarities, which could lead to the presence of multiple equilibria, as it is the case in the interval $[\bar{\lambda}_1, \bar{\lambda}_3]$. However, I must point out that there is a limit to this effect, since values of $\tilde{\lambda}$ such that $\tilde{\lambda} \geq \lambda_M$ do not obtain in equilibrium. I must also point out that the amount issued of IOUs increases at the expense of deposits, which are perfect substitutes from the standpoint of the lenders.

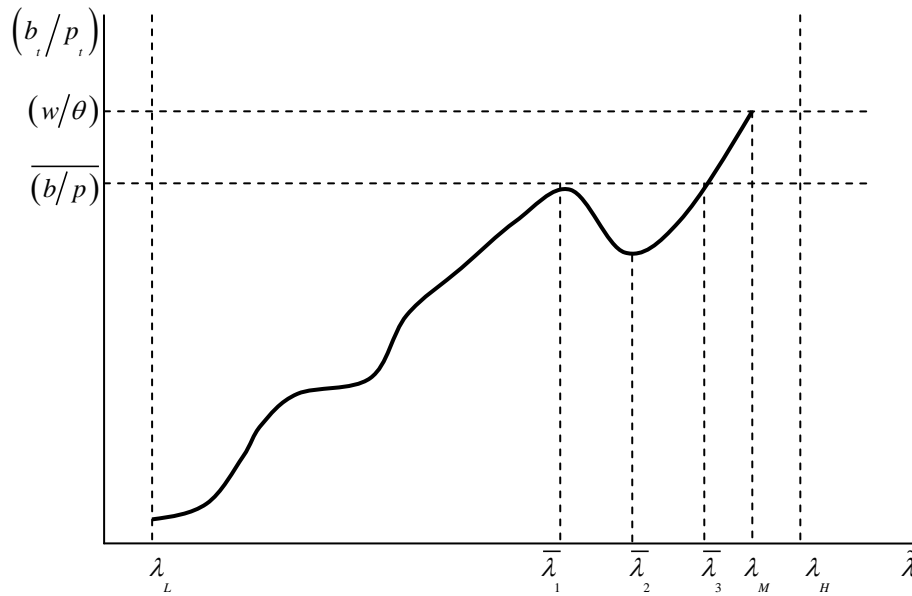


Figure 5: The Amount Issued of IOUs and Multiple Equilibria

The Interest Rate on Deposits and IOUs

The interest rates play a very important role in defining the properties of the equilibrium in this model. I start by discussing the properties of the interest rate on deposits and IOUs. These two interest rates are equal in equilibrium because there is no arbitrage in rates of return on assets that are perfect substitutes. In addition, the return on both deposits and IOUs represent a significant source of income to old lenders. After imposing equilibrium conditions on (16a), one obtains the following expression

$$\hat{R}_{t+1}(\tilde{\lambda}) = \hat{r}_{t+1}(\tilde{\lambda}) = \left[\frac{\alpha \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L)}{p_{t+1} \cdot K^{1-\alpha}} \right] \cdot \frac{L^{1-\alpha}}{(\lambda_H - \tilde{\lambda})} > 0. \quad (26a)$$

The reader may notice that, at date $t + 1$, K_{t+1} is independent of $\tilde{\lambda}$, since it was determined before the shocks are realized. However, this is not the case for L_{t+1} , which is affected by the default of borrowers. One could alternatively regard the interest rate loan in terms of the return on capital, which is a perfect substitute to both deposits and IOUs. Let $k_{t+1} \equiv (K_{t+1} / L_{t+1})$ denote the capital-labor ratio and $\Psi(k_{t+1})$ denote the marginal product of capital. Then, the equilibrium interest rate on deposits can also be expressed as $\hat{R}(\tilde{\lambda}) = \theta_{t+1} \cdot \Psi(k_{t+1}) \cdot (1 - \pi_{t+1})^{-1}$, implying that there is no arbitrage among the returns of all the assets available to young lenders.

Proposition 6 The equilibrium interest rate on deposits and IOUs \hat{R}_{t+1} is nonlinear and convex function of $\tilde{\lambda}$. In particular, \hat{R}_{t+1} is decreasing over the interval $[\lambda_L, \lambda_R)$ and decreasing when $\tilde{\lambda} \in (\lambda_R, \lambda_H]$, where λ_R is such that $d\hat{R}_{t+1}/d\tilde{\lambda}|_{\tilde{\lambda}=\lambda_R} = 0$. Moreover, this interest rate grows without upper bound as $\tilde{\lambda}$ grows closer to λ_H .

Proof: Differentiating (26a) with respect to $\tilde{\lambda}$ yields

$$\frac{d\hat{R}_{t+1}}{d\tilde{\lambda}} = \left[\frac{\alpha \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L)}{p_{t+1} \cdot K^{1-\alpha}} \right] \cdot \left\{ \left[\frac{(1-\alpha) \cdot L^{-\alpha}}{(\lambda_H - \tilde{\lambda})} \right] \frac{dL}{d\tilde{\lambda}} + \frac{L^{1-\alpha}}{(\lambda_H - \tilde{\lambda})} \right\}. \quad (26b)$$

The first term inside of the curly brackets in (26b) is negative and decreasing in $\tilde{\lambda}$, while the second term is positive and increasing in $\tilde{\lambda}$. It is apparent, then, that there exists a value $\lambda^{**} \in (\lambda_L, \lambda_H)$, such that $d\hat{R}_{t+1}(\lambda^{**})/d\tilde{\lambda} = 0$ obtains. Moreover, it transpires that $d\hat{R}_{t+1}(\hat{\lambda}_1)/d\tilde{\lambda} < 0$ for $\forall \hat{\lambda}_1 < \lambda^{**}$, while $d\hat{R}_{t+1}(\hat{\lambda}_2)/d\tilde{\lambda} > 0$ for $\forall \hat{\lambda}_2 > \lambda^{**}$.

Secondly, after evaluating (20a) at $\tilde{\lambda} = \lambda_H$, one obtains

$$\lim_{\tilde{\lambda} \rightarrow \lambda_H} \hat{R}_{t+1}(\tilde{\lambda}) = \theta \cdot \Psi(k_{t+1}) \cdot \left(\frac{\lambda_H - \lambda_L}{\lambda_H - \tilde{\lambda}} \right) = \infty, \quad (26c)$$

which proves the second part of this proposition.

Q.E.D.

Proposition 6 indicates that there may be two equilibria for a given fixed value of the interest rate on deposits $\bar{R} > 0$, as illustrated in Figure 6 below. On the one hand, the value $\hat{\lambda}_1$ corresponds to an equilibrium where the interest rate is \bar{R} and there is a low rate of default. On the other hand, the value $\hat{\lambda}_2$ is associated with an equilibrium where the interest rate is also equal to \bar{R} , but there is a high rate of default instead.

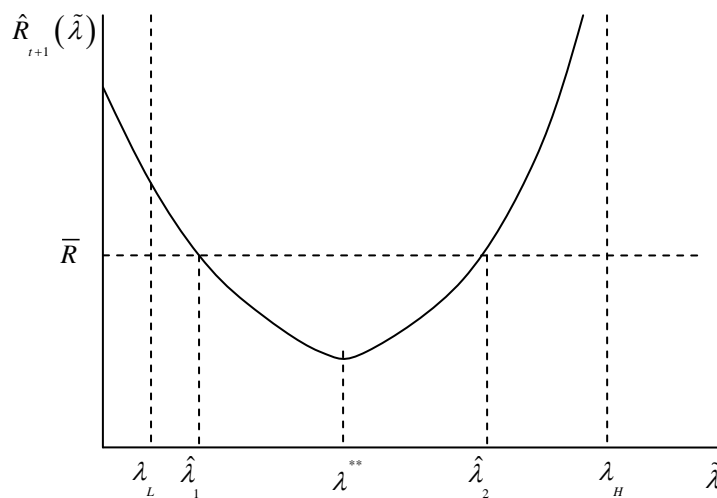


Figure 6: The Interest Rate on Deposits and Multiple Equilibria

The Interest Rate on Mortgages

The equilibrium interest rate on mortgages $\hat{\rho}_{t+1}$ plays a twofold role in this model. First, it is one of the key factors that affect the decision by borrowers of whether to default or not in equilibrium. Second, it represents the main source of income for the old bank, thus affecting her profit and the amount of labor services a_{t+1} that she will be able to purchase and consume. After imposing the equilibrium conditions on (16b), one obtains the following expression for the interest rate on mortgages:

$$\hat{\rho}_{t+1}(\tilde{\lambda}) = \frac{\tilde{\lambda} \cdot q_{t+1}}{q_t \cdot (1-y)} - \left[\frac{\alpha \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L)}{q_t \cdot (1-y) \cdot K^{1-\alpha}} \right] \frac{(b_t/p_t) \cdot L^{1-\alpha}}{(\lambda_H - \tilde{\lambda})}. \quad (27a)$$

It is apparent from (27a) that $\hat{\rho}_{t+1}$ is a somewhat complex function of $\tilde{\lambda}$, making the analysis of its properties a bit complicated. Given the latter, I thus proceed by using a modified version of my fixed-point technique. I present the results in the following proposition.

Proposition 7 The following are properties of $\hat{\rho}_{t+1}$ in equilibrium:

1. $\hat{\rho}_{t+1}(\tilde{\lambda}) \geq 0$ is a smooth, nonlinear function of $\tilde{\lambda}$, such that $(d\hat{\rho}_{t+1}/d\tilde{\lambda}) > 0$ for $\tilde{\lambda} < \bar{\lambda}^*$, and $(d\hat{\rho}_{t+1}/d\tilde{\lambda}) < 0$ for $\tilde{\lambda} > \bar{\lambda}^*$. Moreover, $(d^2\hat{\rho}_{t+1}/d\tilde{\lambda}^2) < 0$, $\forall \tilde{\lambda} \in [\lambda_L, \lambda_H]$.
2. An interest rate on mortgages with meaningful economic content –i.e. $\hat{\rho}_{t+1}(\tilde{\lambda}) \geq 0$ – in this model exists only for the range $[\tilde{\lambda}_1, \tilde{\lambda}_2]$ of its domain, where $\tilde{\lambda}_1 > \lambda_L$ and $\tilde{\lambda}_2 < \lambda_H$ are such that $\hat{\rho}_{t+1}(\tilde{\lambda}_1) = \hat{\rho}_{t+1}(\tilde{\lambda}_2) = 0$.

Proof:

Part 1: After differentiating equation (27a) with respect to $\tilde{\lambda}$, one obtains the expression

$$\frac{d\hat{\rho}_{t+1}}{d\tilde{\lambda}} = \left[\frac{q_{t+1}}{q_t \cdot (1-y)} - \frac{B \cdot (1-\alpha) \cdot (b_t/p_t) \cdot L^{-\alpha}}{(\lambda_H - \tilde{\lambda})^2} \cdot \frac{dL}{d\tilde{\lambda}} \right] - \frac{B \cdot L^{1-\alpha}}{(\lambda_H - \tilde{\lambda})^2} \left[(\lambda_H - \tilde{\lambda}) \cdot \frac{d(b_t/p_t)}{d\tilde{\lambda}} + (b_t/p_t) \right] \quad (27b)$$

where $B \equiv \frac{\alpha \cdot \theta_{t+1} \cdot (\lambda_H - \lambda_L)}{q_t \cdot (1-y) \cdot K^{1-\alpha}} > 0$. It is apparent that the first term on the right hand side of

(27b) is strictly positive and decreasing in $\tilde{\lambda}$, while the second term is strictly negative and nonlinear in $\tilde{\lambda}$. Thus, there exists a value of $\tilde{\lambda}$, that I will denote by $\bar{\lambda}^*$, such that $d\hat{\rho}_{t+1}(\bar{\lambda}^*)/d\tilde{\lambda} = 0$. Moreover, $(d\hat{\rho}_{t+1}/d\tilde{\lambda}) > 0$ holds for $\tilde{\lambda} < \bar{\lambda}^*$, while $(d\hat{\rho}_{t+1}/d\tilde{\lambda}) < 0$ for $\tilde{\lambda} > \bar{\lambda}^*$. All of the above implies that $(d^2\hat{\rho}_{t+1}/d\tilde{\lambda}^2) < 0$ holds⁷⁷, $\forall \tilde{\lambda} \in [\lambda_L, \lambda_H]$.

Part 2: There exist two values of $\tilde{\lambda}$ that I will denote by $\tilde{\lambda}_1$ and $\tilde{\lambda}_2$, such that $\hat{\rho}_{t+1}(\tilde{\lambda}_1) = \hat{\rho}_{t+1}(\tilde{\lambda}_2) = 0$, where $\lambda_L \leq \tilde{\lambda}_1 < \tilde{\lambda}_2 \leq \lambda_H$. Given the proof of part 1 of this proposition, it follows directly that $\hat{\rho}_{t+1}(\tilde{\lambda}) > 0$ for all $\tilde{\lambda} \in (\tilde{\lambda}_1, \tilde{\lambda}_2)$.

⁷⁷ This proof is available upon request.

Q.E.D.

It follows, from Proposition 7, that there exist two equilibria for a fixed real interest rate on loans $\bar{\rho}$, as indicated by Figure 7 below. The first equilibrium is associated with $\bar{\lambda}_1^*$, indicating the low rate of default $\bar{\pi}_1^* = \bar{\lambda}_1^* / (\lambda_H - \lambda_L)$. On the contrary, the second equilibrium has the cut-off value $\bar{\lambda}_2^*$, indicating the high rate of default $\bar{\pi}_2^* = \bar{\lambda}_2^* / (\lambda_H - \lambda_L)$.⁷⁸

I must point out that the latter results are consistent with the equilibrium properties of \hat{R}_{t+1} that I described in Proposition 6. Thus, this economy has the potential for multiple equilibria, which is explained mostly from the fact that strategic complementarities are present in this model economy. One, however, must still be careful when making statements about the number of equilibria in this economy due to the properties of the bank's profits in equilibrium. The latter rule out a set of low enough values of $\tilde{\lambda}$ for which the bank's profits are negative.

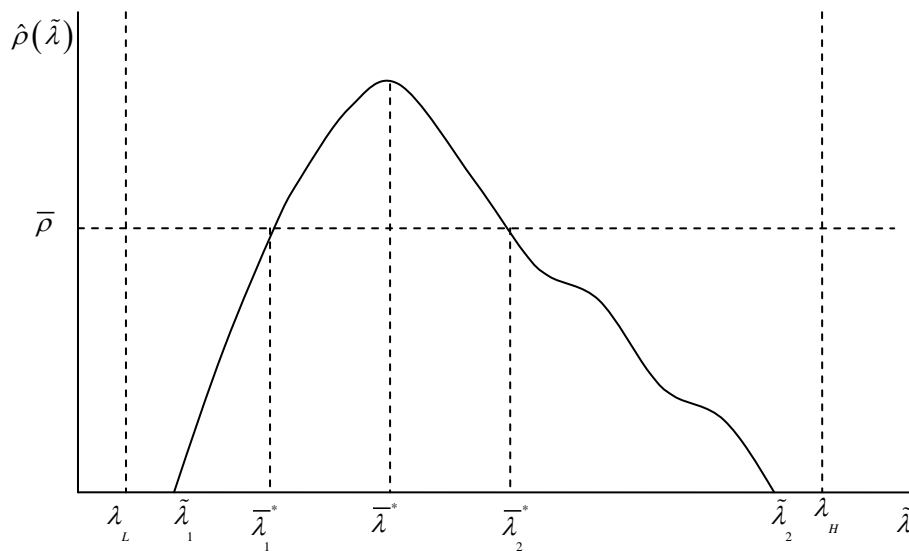


Figure 7: The Interest Rate on Loans and Multiple Equilibria

Preliminary Conclusions⁷⁹

The main properties obtained from my model so far are:

1. There is always a positive rate of default in equilibrium, whether it is unique or not. Moreover, universal default and universal repayment cannot obtain in equilibrium due to the nature of the shock that continuously hits this economy and the signaling to lenders by borrowers, respectively.
2. The equilibrium interest rates on deposits, IOUs and loans display the potential for the existence of two equilibria: one with a low rate of default and the other with a high rate of default. However, the model so far has not produced any criteria for equilibrium selection yet.
3. Contrary to standard intuition, the monopolistic banks obtains positive profits only when the equilibrium rates of default are sufficiently high; my interpretation of this result is that banks are risk lovers in equilibrium.
4. In this model, young borrowers formulate a contingent plan in light of the realization of the shock that they will experience the following period. This works through the choice of a cut-off

⁷⁸ Of course, $\bar{\pi}_1^* < \bar{\pi}_2^*$ obtains.

⁷⁹ I apologize for the lack of flow in my writing, but it is mostly due to my time constraint.

value from the distribution of the shock, such that realizations below the cut-off will lead to defaulting while realizations above the cut-off will lead to repayment.

5. A crisis in this model takes the form of an innovation in the cut-off value of the shock.
6. A crisis reduces total output in this economy by reducing the resources available to purchase labor. Thus, one would expect the GDP to fall in a time of crisis.
7. A crisis also reduces the aggregate welfare of borrowers. However, this effect can be misleading, since the borrowers who default experience welfare gains, while the “honest” borrowers who choose to repay their debt are made worse-off. Thus, contrary to conventional wisdom, these results show that the borrowers who default do not suffer from this shock and that the ones who are in the need of help, probably from government agencies, are the “honest” borrowers.
8. The lenders in this economy (equivalent to the general public who holds deposits on banks) experience significant welfare gains as a result of a crisis. This, then, is another sector that is not in need of government assistance.
9. A crisis increases the bank’s income but reduces its costs, thus increasing the bank’s profits in equilibrium. This result seems to go against conventional wisdom, but remember that there are no investment banks in this model nor mortgage backed securities. This is consistent with the fact that commercial banks seem to be doing reasonable well in light of the subprime mortgage crisis.

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SMALL AND MEDIUM ENTERPRISES AND ENVIRONMENTAL ISSUES: EMPIRICAL EVIDENCES IN ITALIAN CONTEXT

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Abstract:

Social and environmental issue related to companies activity has received growing attention over the last few years; it represents a voluntary approach taken by an enterprise to meet stakeholders' expectations, considering their different features.

Small and Medium Enterprises (SMEs) have begun to show a strong sensitivity towards social and environmental responsibility: the very nature of SMEs does indeed, by and of itself, imply a clear "socially-oriented" dimension; SMEs are deeply rooted in the local communities and many entrepreneurs instinctively understand that behaving correctly towards their employees, suppliers, the community and the surrounding environment represents a strong competitive factor. Unfortunately, this frequently fails to translate into careful planning and structuring of their socially-oriented activities, and into an adequate accountability process. In this sense, they need to formalize and add extra value to the CSR choices and to all the behaviours and strategies that would qualify the company to this end.

In the light of this, the paper aims to investigate the degree of awareness, attention and sensitivity that a sample of Italian SMEs pays towards the social responsibility and, in particular, towards environmental aspect. The study will be conducted by questionnaire on around 3,180 small enterprises.

From a methodological point of view, the research is divided into three main steps:

- 1) theoretical and empirical framework on SMEs and CSR;
- 2) empirical research: method; recording of data; analysis and interpretation of data;
- 3) conclusions, limits and further discussions.

Key Words: Small and Medium Enterprises, Environmental, CSR, Italy

Introduction

Social and environmental issue related to companies activity (Corporate Social Responsibility - CSR) has received growing attention over the last few years; it – represents a voluntary approach taken by an enterprise to meet stakeholders' expectations, considering their different features (Donaldson and Preston, 1995; Freeman, 1984; Mitchell, Agle and Wood, 1997; Werther and Chandler, 2006). Medium and long-term efficient and effective performance in an economic context, in fact, cannot be kept apart from social and environmental responsibility: in an increasingly turbulent environment – regardless of size, activity and sector – companies cannot neglect to assume a solid social orientation while striving towards good economic and financial performance.

As seen in the latest national and international studies, Small and Medium Enterprises (SMEs) have begun to show a strong sensitivity towards CSR (see: Jenkins, 2004 and 2006; Moore and Spence, 2006; Munillo and Lozano, 2006; Perrini, 2006; Spence and Rutherford, 2003). The very nature of SMEs, by and of itself, suggests a clear "socially-oriented" dimension; SMEs are deeply rooted in the local communities and many entrepreneurs instinctively understand that behaving correctly towards their employees, suppliers, the community and the surrounding environment represents a strong competitive factor. Unfortunately, this frequently fails to translate into careful

planning and structuring of their socially-oriented activities, and into an adequate accountability process. In this sense, they need to formalize and add extra value to the CSR choices and to all the social and environmental behaviours and strategies that would qualify the company.

In the light of this, the paper aims to investigate the degree of awareness, attention and sensitivity that a sample of Italian SMEs pays towards the social responsibility and towards environmental aspect, in particular. The survey will be conducted by questionnaire on around 3,180 small enterprises.

From a methodological point of view, the research is divided into three main steps:

- 4) theoretical and empirical framework on SMEs and CSR;
- 5) empirical research: method; recording, analysis and interpretation of data;
- 6) conclusions, limits and further discussions.

SMEs and CSR: theoretical and empirical framework

Small and medium size companies are of the greatest importance in the study of the Italian economic context, owing to the massive presence of such firms in the territory and hence their weight in Italy's productive system. This is confirmed by the data supplied by the *Istituto Nazionale di Statistica*⁸⁰ (National Bureau of Statistics), according to which in 2007 (latest available data) firms with less than 20 employees numbered around 4.3 million⁸¹ with about 10 million employees and an added value of some 318 billion euros. In this class of size, Italy's productive structure accounts for 98.1% of the total firms, 58.8% of all employees, 38.4% of turnover and 44.1% of added value; with reference to the productive sectors, the service segment is the predominant one (74.8% of the firms, 65.4% of employees and 63.7% of added value) with special reference to the trading sector (38.1% of firms, 39.3% of employees, 36.7% of added value) and the firms involved in real estate, leasing, information and other professional activities (33.8% of firms, 27.5% of employees, 35.6% of added value). The construction sector features 14.1% of the firms, accounting for 15.7% of employees and 15.8% of added value, whereas in industry in the strict sense the SMEs with less than 20 employees account for 11.11% of the total, 18.9% of employees and 20.5% of the added value.

It can clearly be seen how the importance of the small and medium firms in the Italian context has stimulated an important amount of research on this theme with particular reference to the specificities that characterize these firms and differentiate them from the large firms. The following points evidence the principal reflections emerging from the study of the theoretical framework⁸²:

- 1) generally speaking, the activities of the small enterprises are mainly directed towards solving daily problems; management entails planning in the short-medium term, often not very formalized and without the aid of precise, rigorous instruments for corporate planning and programming;
- 2) management is oriented predominantly, if not exclusively, by the entrepreneur/owner;
- 3) relations among the various corporate actors and the communications, inside and outside the firm, are not underpinned by precise methods, instruments and time schemes, but are characterized by spontaneity and close dependence on the personality of the subjects heading the firm or entrusted with specific roles in it. In this sense, considerable importance in the SMEs belongs to the interpersonal relationships among the various operators in the firm and, in general, the most successful entrepreneurial projects stem from the particular capacities of these figures or from their spirit of initiative;
- 4) often, firms located in a territory promote or support activities to benefit the community, and subjects of the same community are frequently involved, both as dependents and as trading

⁸⁰ See www.istat.it.

⁸¹ The data presented refer to the annual statistical investigations into the economic results of the industrial and service firms. They provide a detailed picture of the structure and performances of the firms, according to criteria established by a specific EU regulation, i.e. EU Regulation No. 58/97 for structural statistics (SBS – Structural Business Statistics) and subsequent modifications. See www.istat.it. Please also note, the survey UniCredit Observatory, 2009-2010, according to which the population of Small and Medium-sized enterprises in Italy represents the 99.9% of the total population, occupying 81, 3% of the workforce and generating 70.9% of national value added.

⁸² See: Admiraal, 1996; Boldizzoni and Serio, 1996; Cortesi, Alberti and Salvato, 2004; Marchini, 1987 and 2002; Murillo and Lozano, 2006; Spence and Lozano, 2000; VV.AA., 1986.

partners; in this sense, it is almost natural for there to be a close bond between the SMEs and their territory of membership and the relevant community.

It can clearly be seen how, in the light of the above-described characteristics, the approach to CSR by the small and medium firms is influenced by their particular features and how, in this sense, it would be simplistic to extend the reflections of this study on the topic of strategies of CSR of the larger firms which, in general, are more frequently the focus of attention and observation by researchers.

In the light of the characteristics of the SMEs and the differences between them and the condition of the large firms, some authors have investigated the main problems in SMEs' sustainability, and have put forward different perspectives in observing the strategies and behaviours of CSR — and, hence, the devices applicable for correct management and communication by them. The aspects evidenced concern (Russo and Perrini, 2009):

- 1) the different visibility enjoyed by large firms as compared with small ones;
- 2) the strong competitive pressure felt by the smaller firms in the outlet markets;
- 3) for the SMEs, the low formalization of mechanisms and instruments of management and of communication and diffusion of information (Castka, Balzarova, Bomber and Sharp, 2004; Perrini, Pogutz and Tencati, 2006; Russo and Tencati, 2006; Del Baldo, 2010.);
- 4) the significant managerial imprint by the owner actors (Spence, 2000; Jenkins, 2004);
- 5) the importance of human resources and, consequently, the development of good policies and effective management of employees (Spence, 2000);
- 6) the importance for SMEs of the connection with the local community in which they work and the reputation that they have regard to the development of relationships in the social context (Spence, 1999 and 2004; Spence, Schmidpeter and Habisch, 2003; Tencati, Perrini and Pogutz, 2004).

In regard to the assumption of social and environmental responsible behaviour, an important factor influencing the definition of CSR strategies is the characteristic values of the entrepreneur/owner of the firm (Murillo and Lozano, 2006; Quinn, 1997; Spence and Rutherford, 2003; Spence, Schmidpeter and Habisch, 2003). In small firms, characterized by short-term management, profoundly dependent on the choices of one or a few subjects and strong personal relationships among the various corporate actors, the moral and ethical codes determining the *modus agendi* of the entire organization are generally highly dependent on the sensitivity and personal predisposition of those at the head of the firm (usually the owners) who identify and shape decisions and initiatives of social responsibility stemming from their own values. The latter often merge with the values of the firm, consistently with the strong synchrony, mentioned above, that exists between firm and entrepreneur, also in regard to management.

Another important element to consider in the study of CSR in the SMEs concerns the culture and organizational modalities characterizing the firm's management. These aspects acquire a fundamental importance as regards the possibility to formulate and implement strategies of CSR. In addition to the moral-ethical values directing entrepreneur and firm, in the study of CSR in small firms it is important to consider also the style in which the firm is managed and the resulting predisposition of the entire organization to start and develop CSR initiatives in it (Spence, 1999; Vyakarnam, Bailey, Myers and Burnett, 1997).

In a different perspective, assessment must be made of the nature and ways of the relationships that are established between the subjects in the firm and between the firm and the outside context. Indeed, it is extremely significant to understand the pattern of the relationship among the subjects operating within the firm (owner and employees, figures responsible for different roles and characterized by a different position in the hierarchy). As mentioned, the strong personal imprint characterizing the relationships in the firm determines the appearance of modalities and circumstances that are absolutely original and atypical in each situation. Usually, these capacities to create positive relations represent an element of success for SMEs; this observation is an important factor to consider also with reference to CSR with regard to the need – according to the type of relationship formulated among the firm's actors – to establish CSR strategies that are shared, promoted by the heads of the firm or, *vice versa*, brought about at lower levels in the hierarchy. In this sense, particular importance is assumed by the relationships with the employees who represent a critical success factor in SMEs. The devotion and validity of the employees and collaborators, as well as the ability to valorise

potentialities to the maximum, are often among the principal intangible assets of a SME (Murillo and Lozano, 2006; Spence 2000; Spence and Lozano, 2000).

Also the profile of relationships – or relational networks – between the firm and the outside context constitutes a fundamental element with regard to the policies of CSR. An ample bibliography (for example: Spence, Schmidpeter and Habisch, 2003; Granovetter, 1985 and 2000; Enderle, 2004) testifies how attention to positive and strong relationships between firm and economic and social context facilitates the creation of a tissue of collaboration and mutual assistance that involves the operators directly engaged (workers, customers and suppliers) and extends to embrace subjects more external and distant such as institutions, competitors and the collectivity. As evidence of this, one of the more direct effects deriving from this attention to relationships among the various interlocutors is represented by improvement in a firm's reputation, a greater trust in and loyalty to the firm (Vyakarnam, Bailey, Myers and Burnett, 1997).

On the other hand, it is evident how the very characteristics of the small firms may favour the assumption of socially responsible attitudes. In general, for the small size is associated with a strong presence on the part of the entrepreneur/owner, as noted, with intense, stable relationships among the operators in the firm and between the firm and the surrounding community or territory, and with a dynamic, flexible management directed towards short-term projects. In this sense, many CSR initiatives – connected e.g. with the protection and satisfaction of employees, support for the community of reference, promotion of the territory, management of positive networks of relationship with trading and other partners – are very much in the nature of the SME. A greater flexibility and a more marked propensity to find solutions that will satisfy the various subjects involved in transactions are features intrinsic to the ways of operating of the SMEs and often generate competitive advantages for them.

What they frequently lack, however, is the ability to structure and formalize the initiatives they implement into precise projects and strategies.

Parallel to the studies described – that analyze by a theoretical approach the characteristics of SMEs in relation to the assumption of CSR – over the last decades national and international researches (with a strong empirical character) have been spread with the specific aim of analysing the most important actions of SMEs with regard to social and environmental issues as well as the main stakeholders considered from small and medium enterprises⁸³. (In particular for Italy: Chamber of Commerce of Milan and Formaper, 2004; Molteni and Lucchini, 2004; Longo, Mura and Bonoli, 2005; Bertolini, Molteni and Pedrini, 2006; Perrini, Pogutz and Tencati, 2006; Molteni and Todisco, 2007; Perrini, Russo and Tencati, 2007; Russo and Tencati, 2008; Maticena and Del Baldo, 2009, Caroli and Tantalo, 2010; Del Baldo, 2010. For research in Europe: Graafland, Van de Ven and Stoffele, 2003 (Netherlands); Abreu, David and Crowther, 2005 (Portugal); Jenkins, 2006 and 2009 (UK) Assemblée des Chambres Françaises de Commerce et d'Industries, 2006 (France); Berger and Douce, 2008, Agence de l'Environnement et de la Maîtrise de l'Energie, 2009; Confédération Générale de Petite and Moyennes Entreprises et du Patronat Réel, 2010; Spence and Lozano, 2000 (comparing the UK and Spain); Spence, Jeurissen and Rutherford, 2000 (comparison UK and the Netherlands), Spence, Schmidpeter and Habisch, 2003 (comparing the United Kingdom and Germany)).

From these researches it is possible to synthesize a framework that describes the main features of the CSR behaviour of SME:

- 1) there is a positive correlation between knowledge and engagement in social and environmental responsible activities;

⁸³ Note, also, the attention given to the issue by the European Commission that, in the year 2000, has promoted the "First European Business Convention on CSR" and in 2001, it published a Green Paper "Promoting a European Framework for Corporate Social Responsibility". With specific reference to SMEs, in 2002, a report titled "European SMEs and Social and Environmental Responsibility. Observatory of European SMEs, 4" was published. It was the result of a survey of 7,600 companies spread over 19 countries. To this report other documents are followed: in 2003 "Responsible Entrepreneurship. A Collection of Good Practice Cases Among Small and Medium-Sized Enterprises Across Europe"; in 2004: "European Multistakeholder Forum on CSR: Report of the Round Table on Fostering CSR among SMEs"; in 2007: "Opportunity and Responsibility. How to Help More Small Business to integrated Social and Environmental Issues into What They Do".

- 2) the knowledge and the adoption of social and environmental responsible activities increase as the size and business structure; these issues are more significant for the companies included in networks also of international importance;
- 3) the propensity to social and environmental responsible behavior is higher in firms that provide positive effects from an economic point of view;
- 4) non-commitment to issues of CSR depends on the lack of information and the prevalence of other priorities;
- 5) the most significant commitment is towards the environment (waste treatment, emission control), employees (health and safety), the local community (donations and sponsorships, direct involvement of employers and employees) and initiatives of general interest (research, human rights, international cooperation, environment); the commitment towards the community often is expressed in attention to environmental impacts (introduction of a line of products with specific environmental value or formalization of their responsibilities, objectives and the tools to reduce the environmental impacts of management);
- 6) customer care, if any, is related to safety and quality of the product or service and there are not significant direct actions towards the suppliers;
- 7) low awareness of CSR tools (social report, code of ethics and environmental certification);
- 8) emergent interest in the quality and environmental certifications.

In particular with reference to the *environment*, the most important actions are related to the adoption of separate collection of waste systems and to the control of emissions of pollutants. Furthermore, comparing the CSR strategies adopted by large and small and medium-sized Italian companies (Perrini, Russo and Tencati, 2007) in the field of environment, it is possible to note that the attention of big companies is still very much greater than that of the small and medium businesses that have less knowledge on the subject and, in general, less financial resources to invest.

Empirical research: method, sample and questionnaire

The empirical research, based on questionnaire, was performed in the course of about a year. It was aimed at the universe of the small firms (typically artisan firms) located in the province of Parma (Italy). The units subjected to analysis totalled 3,189: the number of the firms associated to *Confartigianato Apla* Association (association of artisan enterprises) in March 2008.

The first step of the research was to analyse the universe: juridical nature, area of location, number of employees and sector of activity (the classification complies with the criteria adopted by the Association).

With regard to the juridical form, the prevalent firms are individual (about 61%), general partnerships (about 21%) and limited liability (about 13%).

A large number of the firms are located in lower part of the province of Parma (west: 27%; east 50%) and a significant percentage (about 14%) work in the mountainous western area.

The majority of the universe (84%) employ between 1 and 5 persons (hence are *micro firms*); 9% have between 6 and 10 employees.

Lastly, a goodly part (about 44%) of the firms work in heavy industry (building, plant and metal engineering), while an important proportion (about 15%) is represented by the service and tertiary sector.

On the basis of the theoretical analysis (definition of hypothesis) the questionnaire was prepared. It aims, at a first level, to verify the sensitivity of the firms with regard to social and environmental responsibility asking questions (mainly in closed form: *yes, no, sometimes, don't know, no reply*) referring to: employees/collaborators (19 questions), community/territory/institutions (7 questions), customers/consumers (5 questions), suppliers (4 questions) and environment (16 questions). Table 1 sets out the topics of analysis for each category of stakeholder.

Table 1 – The questionnaire: stakeholders and main topics

Employees/ collaborators	Community/territory/ institutions	Customers/ consumers	Suppliers	Environment
Type of contract	Promotion of sporting, cultural and religious events	Ways of collecting opinions	Ways of collecting opinions	Environmental impact of the activity
Timetable flexibility	Participation in sporting, cultural and religious events	Consideration of complaints	Registration and response to complaints and requests	Waste recycling
Training	Promotion of housing works in the community	Response to requests	Sustainability of the supply chain	Energy saving
Corporate atmosphere	Collaboration in construction of housing in the territory	Opening hours	Territoriality	Pollution
Health and safety		Product quality		Pro-environment campaigns and initiatives
Work outside community				Use of data instruments relating to the topic
Work of family members				

A total of 519 completed questionnaires were delivered, corresponding to some 16% of the universe; this sample turned out, overall, to be representative of the universe of analysis with regard to nearly all the variables considered⁸⁴, as is evidenced in the following tables.

Table 2 – Universe and sample: analysis of the juridical form

<i>Juridical form</i>	<i>Universe</i>		<i>Sample</i>	
	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>
Cooperative firms	7	0.22	1	0.19
Associations of artists and professionals	1	0.03	0	0.00
Non-recognized associations and committees	7	0.22	0	0.00
Consortia	11	0.34	0	0.00
Individual firm	1,959	61.43	357	68.79
Società a responsabilità limitata – Srl (limited liability firms)	422	13.23	53	10.21
Società in accomandita per azioni – SapA (limited share partnership)	1	0.03	1	0.19
Società in accomandita semplice – Sas (simple share partnership)	87	2.73	5	0.96
Società in nome collettivo – Snc (general partnerships)	660	20.70	100	19.27
Società per azioni – SpA (joint stock company)	12	0.38	2	0.39
Amateur sporting firms	1	0.03	0	0.00
Not codified	21	0.66	0	0.00
<i>Total</i>	<i>3,189</i>	<i>100.00</i>	<i>519</i>	<i>100.00</i>

Table 3 – Universe and sample: analysis of the district area

<i>District area</i>	<i>Universe</i>		<i>Sample</i>	
	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>
Eastern Low Area	1,577	49.45	151	29.09
Western Low Area	876	27.47	172	33.14
Eastern Mountain Area	235	7.37	83	15.99
Western Mountain Area	432	13.55	106	20.42
Not codified	69	2.16	7	1.35
<i>Total</i>	<i>3,189</i>	<i>100.00</i>	<i>519</i>	<i>100.00</i>

⁸⁴ The sole case where the sample is not completely representative of the universe concerns the territorial distribution of the firms. This is most probably to be ascribed to the difference in reception of the questionnaire (personal delivery or mail).

Table 4 – Universe and sample: analysis of number of employees

<i>Number of employees</i>	<i>Universe</i>		<i>Sample</i>	
	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>
0	1	0.03	0	0.00
1	1,532	48.04	239	46.05
from 2 to 5	1,155	36.22	182	35.07
from 6 to 10	287	9.00	55	10.60
from 11 to 30	190	5.96	37	7.13
from 31 to 50	15	0.47	4	0.77
from 51 to 70	4	0.13	1	0.19
from 71 to 90	2	0.06	0	0.00
from 91 to 110	2	0.06	1	0.19
More	1	0.03	0	0.00
<i>Total</i>	<i>3,189</i>	<i>100.00</i>	<i>519</i>	<i>100.00</i>

Table 5 – Universe and sample: analysis of sector of activity

<i>Sector</i>	<i>Universe</i>		<i>Sample</i>	
	<i>No.</i>	<i>%</i>	<i>No.</i>	<i>%</i>
Fashion	107	3.36	22	4.24
Food	183	5.74	28	5.39
Artistic	32	1.00	3	0.58
Motor repair	204	6.40	36	6.94
Wellness	271	8.50	32	6.17
Construction	693	21.73	135	26.01
Communication and innovative services	130	4.08	16	3.08
Plant	289	9.06	47	9.06
Wood and furnishing	141	4.42	28	5.39
Metal engineering manufacture	434	13.61	81	15.61
Transport/logistics/mobility	214	6.71	35	6.74
Services and tertiary	489	15.33	55	10.60
No indication	2	0.06	1	0.19
<i>Total</i>	<i>3,189</i>	<i>100.00</i>	<i>519</i>	<i>100.00</i>

After collecting the completed questionnaires, the responses were carefully analysed.

Empirical research and interpretation of data

The data collected from the responses to the questionnaires were analyzed with particular reference to environmental issues which appears to be, such as demonstrate by the studies analyzed in the previous paragraph, a topic of emerging interest for SMEs.

In particular, we interpreted the data in the light of the characteristics/variables that link the firms, with special reference to: juridical form, number of employees and sector of activity. The difference and, at the same time, the homogeneity between the firms in terms of attitudes towards and initiatives of corporate social responsibility can furnish evidence of a more or less developed and aware approach with regard to the topic of analysis, which varies according to the classifications made among the firms.

A further important element to be considered in reading the data is the formulation of two types of questions within the questionnaire. The firms were questioned not only as regards the operative proposals adopted in the context of social and environmental responsibility but also concerning how they perceive the topic. Analysis of the data was performed, firstly, with regard to the operative aspects concerning the initiatives and operative modalities by which the firms have undertaken socially rewarding behaviours. For that matter, it is clear that the research was also concerned to know the awareness, sensitivity and maturity of thought present in the firms with regard to the topic.

Concerning environment, the study observed the following three main aspects:

- awareness by the firm of the environmental impact of the activity performed;

- behaviours and operating practices adopted by the firm for environmental protection;
- action for responsibility and environmental protection proposed by the firm.

The empirical research shows that the small firms in our sample are not deeply acquainted with the impact on the territory their activity may have: as only 37% of companies said they had evaluated, at least once in the year, the environmental impact of the activity. It should be noted, however, that the data is strongly influenced by the presence of companies with only one employee (in these cases is very difficult to study the effects of their activities on the environment). In cases in which companies have a major numbers of employee the percentage increases reaching respectively values of 45% and 58%.

The datum that emerges with regard to evaluation concerning problems of environmental nature connected with the firm's activity conflicts with the foregoing results, inasmuch as we find that 53% of the SMEs deny the existence of environmental problems linked with their work. Knowledge in this connection, in the majority of cases, would seem to be not very deep, since it is based on personal opinions rather than effective, structured evaluation and investigation.

Then the analysis focused of the behaviours and operating modalities adopted with regard to environmental protection.

Concerning the measures undertaken for *prevention of pollution*, nearly one half of the firms (49%) replied that they took no initiatives for this purpose. The 32% that do address these problems cite the following preventive measures:

- emission of air- and water-polluting substances (28%);
- acoustic pollution (24%);
- landfills (38%);
- use of material with low environmental impact (21%).

As regards the steps taken for *energy saving*, the analysis reveals that 21% of the firms act towards this aim, while 10% undertake sporadic, and therefore not structured, initiatives. In particular, where steps are taken to reduce waste (24%), it turns out that the sectors most concerned in this practice are construction (21%) and engineering (21%).

Lastly, and again in regard to behaviour aimed at environmental protection, questions were asked about *recycling*. Interpretation of the data shows that 44% of the firms take steps to optimize wastes by means of differentiated waste collection and reliance on specialized operators (37%). In this case, too, the sectors most involved are those of construction and engineering, with 25% and 18% respectively.

The results on the adoption of measures for environmental protection, in the three aspects analyzed (pollution, energy saving and recycling) are presented in the following table (Table 6):

Table 6 - Presence of working practices adopted in favor of environmental protection, in relation to company size (percent)

<i>Working practices for environmental protection</i>	<i>Only 1 employee</i>	<i>Micro</i>	<i>Small</i>	<i>Medium</i>	<i>Total</i>
<i>Pollution Prevention</i>	25,10	55,27	75,61	100,00	43,16
Pollutants to water and air	25,94	40,08	60,98	50,00	35,26
Noise	19,25	35,44	60,98	50,00	30,06
Landfills	35,56	46,84	51,22	100,00	42,20
Use materials with low environmental impact	28,45	39,24	43,90	100,00	34,87
<i>Energy Savings</i>	16,74	38,40	60,98	100,00	30,44
<i>Recycling of waste</i>	39,33	63,71	87,80	100,00	54,53
Programs to reduce waste	25,10	43,04	68,29	100,00	36,99
Differentiated waste collection	46,44	69,20	85,37	100,00	60,12
Use of specialized operators	29,28	51,48	75,61	100,00	43,35

For all the investigated practice we observe that firm size has a positive effect on the measures taken for the purpose of environmental protection.

The last aspect to be analysed were the actions to encourage awareness of environmental protection. In this connection, the empirical survey reports rather negative results, since it turns out that the majority of the firms (71%) do not make use of information instruments in this regard

(participation in conferences, recourse to specialized operators, and so on), nor do they promote and support campaigns or initiatives to safeguard the environment (89%).

Conclusion

The theme of social and environmental responsibility does not, of course, concern only the large firms; the situation of the SMEs, and especially of the micro enterprises, is much more sensitive in this connection, despite the evident differences from a structural, economic and financial point of view. The main studies on the topic of CSR and SMEs have evidenced how, in the matter of small and medium enterprises, it is important, firstly, to define paths that will help them to identify the main contexts of social and environmental responsibility. Thereafter, the most suitable devices must be found for a correct management and communication of the CSR projects undertaken with the aim of translating them into precise management strategies, reaching beyond mere extempore initiatives connected with particular events as these occur.

Previous empirical study has seen the categories of stakeholder as of greater importance in respect of the situations of the SMEs: dependents and collaborators, community, territory and institutions, customers and consumers, suppliers, environment. The present study aimed to investigate in particular the environmental issues, in the light of the emerging importance of this topic for SMEs and with regard to the relevance of this also as far as community relations is concerned.

In particular, the study investigated both how the SMEs perceive the importance of environmental issue, both the proposals and initiatives actually adopted in this connection. In this sense, it is evident how a first area of interest in the study concerns the understanding of the level of attention to environmental issue of the small firms and what they have achieved in the matter. So, we observed mainly the aspects relating to awareness by the firms of the environmental impact of their activities, the behaviours and practices adopted for environmental protection, and the possible actions towards sensitivity and safeguard of the environment proposed by the SMEs.

The firms pay particular attention to this aspect: in the majority of cases they address environmental problems by implementing specific initiatives for preventing pollution, saving energy and recycling waste.

Nonetheless we find some incongruences in the data that suggest that many of the initiatives undertaken have to do with personal sensitivity (often partly originating and promoted by normative interventions with relation to the environment) and do not stem from a structured path in the management of this matter.

Lastly, about the limits of the study, we remarked the use of the questionnaire as a data collection tool. It is evident that the data relate solely to the firms who opted to take part in the study – in general, firms more sensitive to the topic. Nevertheless, the representativeness of the sample with respect to the starting universe enables us to limit the problem in question.

Moreover, use of a predefined questionnaire raises certain problems inherent in the instrument, such as the presence of questions and answers predetermined *a priori*, or the risk of incorrect interpretation of these. We note, lastly, that the results of the study may have been influenced by the non-homogeneous diffusion according to the localization of the firms.

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COMPETITIVENESS OF THE EU ECONOMIES AND DEVELOPMENT OF CLUSTERS

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Abstract:

The role of business clusters in building competitive advantage of national economies is a subject of numerous discussions. It is rather quite commonly agreed that well developed business clusters are supposed to be drivers of innovation and competitiveness of economy in multifold dimensions. In the article a hypothesis, which states that occurrence of numerous and strong clusters in a country is positively related to competitiveness of its economy is being tested. Using a dataset on cluster mapping in Europe from the European Cluster Observatory and results of the country competitiveness rankings published by the World Economic Forum in the Global Competitiveness Reports as well as data on the levels of Gross Domestic Product (GDP) from World Bank we have looked for a relationship between occurrence and relative strength of clusters in the EU-27 countries and the measures of competitiveness such as the competitive potential and productivity of the EU national economies. It appeared from the analysis that those countries differ in terms of both occurrence and relative strength of business clusters as well as levels measures of their competitiveness such GDP per capita and the competitive potential. Nevertheless, statistical evidence for relationships between variables under consideration was not found what leads to some suggestions regarding cluster mapping methodology and further studies in this area, which could result in formulating useful recommendations for public policies aimed at development of clusters.

Key Words: Economic development, competitiveness, clusters, the EU

Introduction

A need for efforts to increase competitiveness of the EU economy have been emphasized in many policy agendas including recent Europe 2020 growth strategy for the coming decade (e.g. European Commission, 2010). As pointed out in one of the communications from the EU Commission a very important way to improve competitiveness is through the development of “world-class clusters” (European Commission, 2008). Such recommendation stems from a widely spread view that not companies themselves but strong clusters are vehicles for competitiveness and innovations.

The concept of clusters is not completely new and has evolved over time. Ever since Marshall’s considerations on “thickly peopled industrial districts” (Marshall, 1920) location and concentration have played a significant role in economic thought. The works of Italian scientists on *distretti industriali* (e.g. Becattini, 1979, Becattini, 1991) have also contributed to today’s relevance of spatial economics theory and practice among scientists and policymakers. This article is based on the currently most accepted concept of clusters defined as geographic concentrations of interconnected companies, specialized suppliers, service providers, firms in related industries, and associated institutions (for example universities, standards agencies, and trade associations) in particular fields that compete but also cooperate (Porter, 1998).

Spatial distribution of economic activity stems from uneven distribution of human population, among other reasons. Certain industries choose specific locations due to the existence of various factors, e.g. the existence of natural endowments. Industrial concentration occurs in certain regions and is explored by many authors (Krugman, 1991, Ellison and Glaeser, 1997, Porter, 1998). In some cases geographic concentration of companies results in the form of clusters. Clusters can be part of

every economy, irrespective of its stage of development, and are formed by and in numerous industries. Their role in innovation and economic development is under great scrutiny. The concept is also frequently brought into the debate on gaining and sustaining competitiveness at country, industry and microeconomic levels. Externalities play a significant role in cluster performance as they link its elements (Porter, 2003). Hence, one of the main characteristics of this concept is the importance of intercompany relations – a particular trait that differentiates clusters from other types of agglomerations and puts stress on related as well as supporting activities.

Clusters are present throughout Europe. Some have developed over centuries, others are a result of rapid changes in contemporary times. European clusters vary among each other in many dimensions, such as their geographic scope or number of industries that form them. The disparities that occur result from differences among particular regions and countries (Ketels and Sölvell, 2006). One of the first steps of cluster analysis is the identification of their existence, which consists of separating cluster-type interdependencies among industries. Fundamental dimension of a cluster occurrence is the level of employment. If in certain sectors or types of economic activities it is noticeably higher than in other parts of a national or regional economy a cluster-type relationships develop. This can also be seen as sign of economic specialization resulting from comparative advantage. Therefore, if clusters are supposed to be important for building competitiveness their development should eventually translate into observable economic effects such as, for instance, a strong competitive position and high productivity of an economy. Having considered this assumption implausible would seriously undermine rationale of policies aimed at development of clusters. In this context the objectives of the article are to identify distribution and relative strength of business clusters in the EU member countries and compare them with the competitiveness of their economies. The key research question is whether the existence of strong clusters is positively related to the measures of competitiveness of national economies. If so, a hypothesis that development of clusters contributes to improvement of competitiveness would be empirically supported.

Competitiveness of the EU economies

Competitiveness of the economy can be evaluated from various perspectives. In our analysis we consider two partly interrelated dimensions such as competitive potential and productivity of the economy. With regard to the first dimension we use results of widely known and very comprehensive study published on the yearly basis by the World Economic Forum as the Global Competitiveness Report (GCR). The GCR examines national competitiveness of many economies. GCR's definition of competitiveness states that it is the set of institutions, policies, and factors that determine the level of productivity of a country. The measure it employs to estimate competitiveness is the Global Competitiveness Index (GCI), within which numerous factors are taken into consideration. The GCI is a weighted average of components that belong to 12 groups named pillars of competitiveness named as follows: institutions, infrastructure, macroeconomic environment, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness, market size, business sophistication, innovation. The final score of the GCI for a country is based on successive aggregations according to the structure of the Index starting at the indicator level. Figure 1 illustrates the average country scores for the period 2006/07-2012/13 (horizontal line is the mean value).

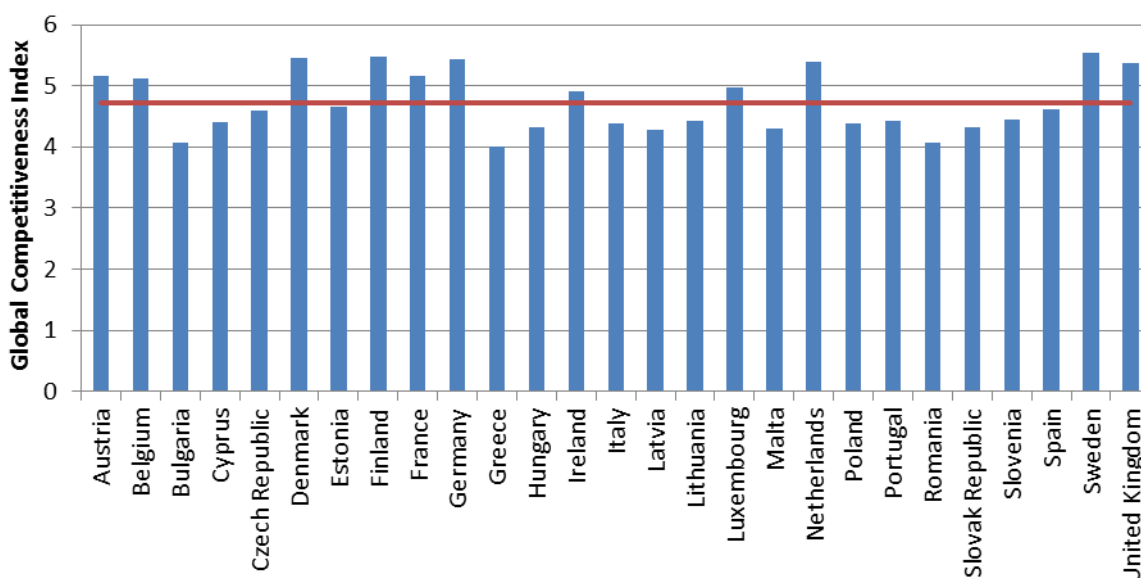


Figure 1. The average GCI scores of the EU countries for the period 2006/07-2012/13

As it can be noticed eleven countries have the values of the GCI above the mean, which accounts for 4.73, whereas sixteen of them have values below it. However, the differences between the EU economies in this respect are relatively small considering the GCI standard deviation of 0.5 and coefficient of variation of 10,5%.

Regarding the second dimension of the competitiveness, which is productivity of the EU national economies, it is shown in figure 2 using the average levels of GDP per for the period from 2005 to 2011 (horizontal line is the mean value).

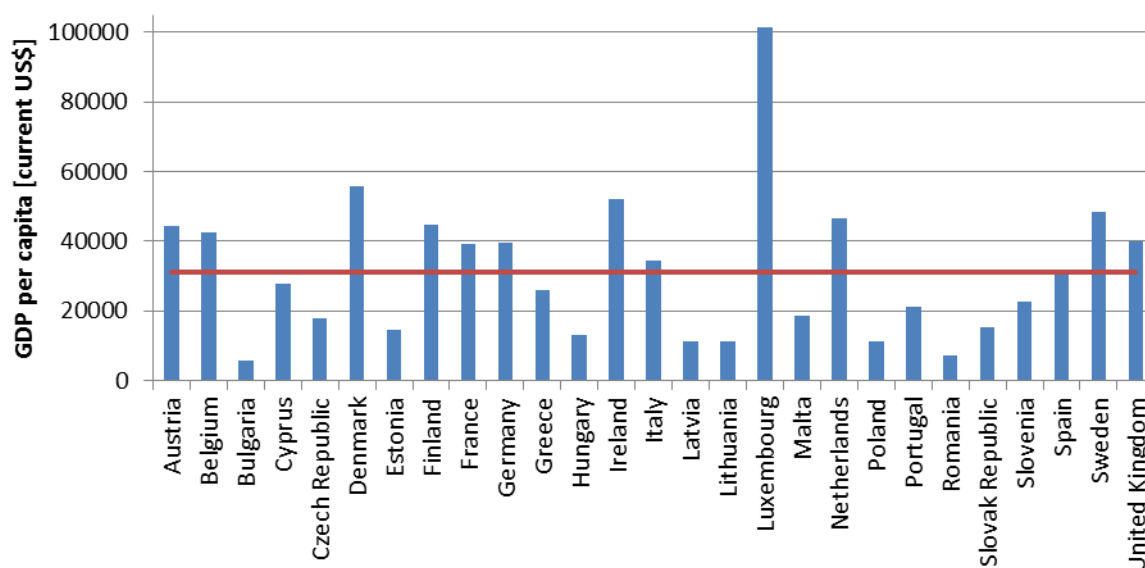


Figure 2. The average GDP levels of the EU countries for the period 2006/07-2012/13

The GDP per capita levels are much more differentiated with a mean of 31.2 thousand US\$ and a standard deviation of 20.6 (coefficient of variation of 65,9%). What might be considered interesting, there is a quite strong and statistically significant (at the level of $\alpha < 0,01$) relationship between the GCI scores values and GDP per capita levels (figure 3). On one hand it may mean that competitive potential translates somehow into productivity of an economy, and thus, economic welfare of a country. But, on the other hand this also suggests that not all the EU countries use fully or effectively their competitive potential since a fairly big portion of the GDP variation remains unexplained by the variation of the GCI scores.

Occurrence of clusters in the EU economies and their competitiveness

The European Cluster Observatory (ECO) dataset on cluster mapping provides information about regions and sectors in selected European economies in which NUTS2 regions are the basic level of analysis. Sectors are statistically converted into clusters based on agglomerations of employment using data predominantly on the 4-digit level of NACE.

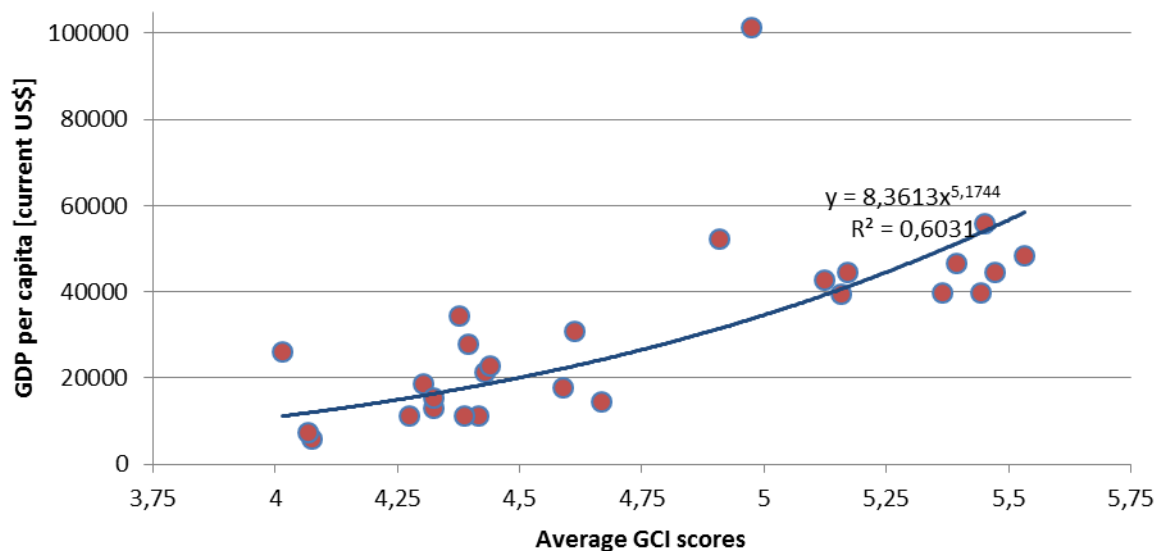


Figure 3. The relationship between the GCI scores and GDP levels of the EU countries

The ECO methodology of measuring cluster strength is based on three dimensions in which if a criterion is met a star is given to a cluster. Altogether each cluster can be given one, two, or three stars. The first dimension taken into consideration is the size of a cluster. A star is awarded to a cluster if the agglomeration of employment within the cluster category in a region is among top 10% of the given type of cluster in Europe. The second dimension uses the location quotient as a measure of specialization. LQ at a level of at least two grants a star to a cluster. The third dimension refers to the share of cluster employment within overall employment of a region. The 10% of clusters with the largest share in region’s employment receive a star. Figure 4 illustrates the number of clusters and their strength by countries.

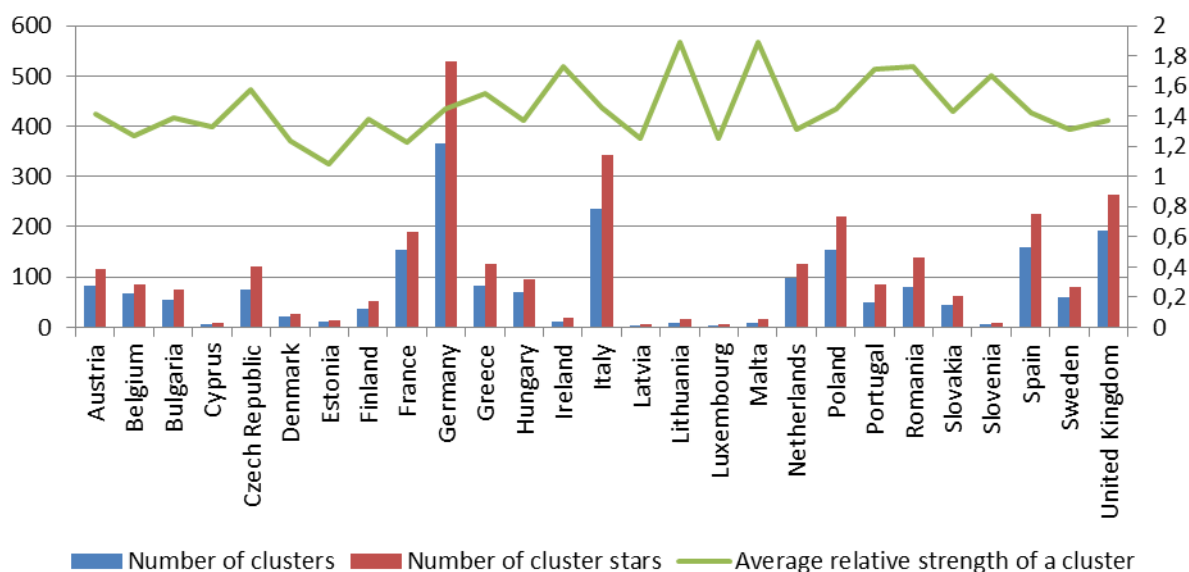


Figure 4. The occurrence of clusters and their relative strength in the EU countries

A great variation can be observed among the EU countries considering both the number of clusters and total number of stars granted to them according to the ECO methodology. The number of identified clusters ranges from only 4 in Latvia to as many as 365 in Germany, whereas the total number of stars granted to the all clusters in a country is even in a wider range i.e. from 5 to 529, again in Latvia and Germany, respectively. Both the number clusters and the total number of stars appeared to be very highly correlated with countries GDP. In the first case coefficient of correlation amounted 0.9 and in the second one to 0.88. It is a clear evidence that occurrence of clusters is dependent on the size of economy. This seems to be understandable as larger economies are likely to have much more diverse specialization profiles than the smaller ones.

Looking for a connectedness between occurrence and relative strength of clusters in the EU economies and their competitiveness we tested for correlations between the number of clusters and the number of granted stars and the GCI scores and GDP per capita levels. Table 1 includes the results. In addition, figure 5 depicts positioning of the EU economies taking into the number of identified clusters and GDP per capita levels.

Table 1. Coefficients of correlation between the number of clusters and the total number of stars granted and measures of competitiveness of the EU national economies

Measures of competitiveness	Occurrence and relative strength of clusters	
	Number of clusters	Number of stars granted
The GCI scores	0.26	0.21
The GDP per capita levels	0.04	0.01

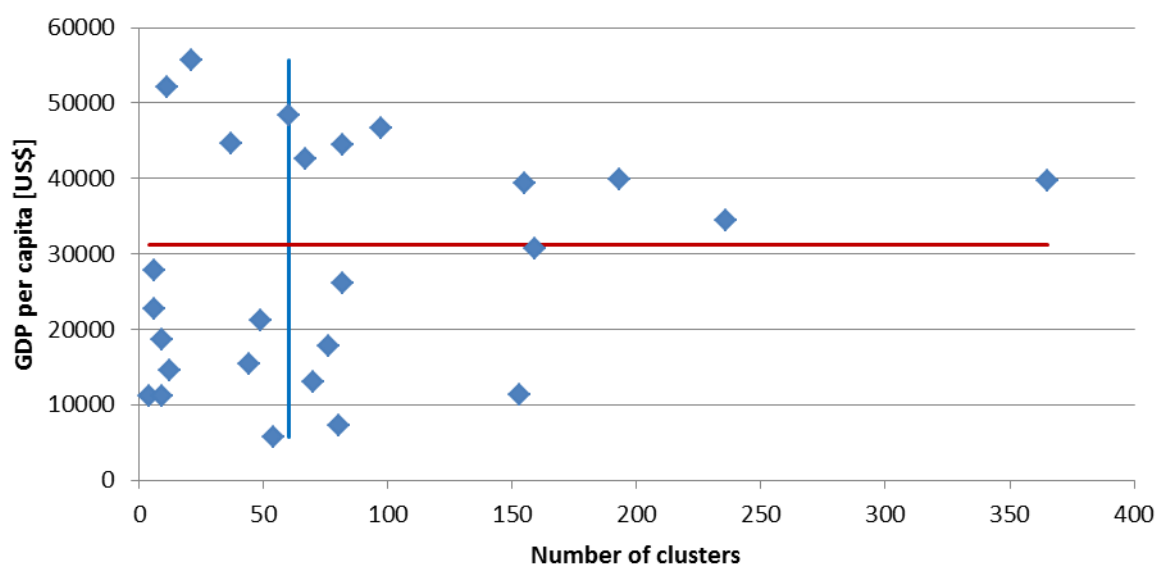


Figure 5. The number of business clusters versus GDP levels of the EU countries

Although the calculated correlation coefficients take expected positive signs they should be disregarded as being statistically insignificant (especially the ones for the GDP per capita levels). An explanation for the lack of statistically proven connectedness between occurrence and relative strength of clusters and the applied measures of competitiveness of the economies can be drawn from figure 5, which in a sense presents a four parts matrix showing where particular countries (Luxembourg was omitted as an outlier) can be allocated with reference to the number of clusters (below or above the median value represented by the vertical line) and the levels of GDP per capita (below or above the mean value represented by the horizontal line). As it can be seen the countries are distributed in the matrix in such a manner that existence of a relationship cannot be really expected.

Conclusion

According to some opinion makers development of business clusters and supporting cluster initiatives is an obvious solution to improve competitiveness of the EU national economies. Unquestioned acceptance of such a view seems to be taken for granted without critical assessment of

the impact of clusters on the competitiveness of economies. Unfortunately, our findings do not support this type of view if cluster phenomenon analyzed at a macroeconomic level. A direct relationship between the occurrence and relative strengths of clusters and the competitiveness of the EU national economies member was not found. Hence, a hypothesis that existence of strong business clusters may have a positive impacts on competitiveness of the EU national economies cannot be confirmed. However, it has to be stressed that our analysis is not free from caveats. First of all the classification of clusters used in the analysis can be considered debatable as the employment data may be inadequate to properly identify existence of clusters and assess their strength. Other economic variables and qualitative factors like cooperation within the clusters and level of social capital, which may play important role are simply omitted. Finally, the connection between existence of clusters and competitiveness of economies may not be direct, therefore, when designing policies aimed at supporting cluster development all potentially important linkages should be examined with great scrutiny.

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POSITION OF CEE AND HUNGARY ON THE GLOBAL SHARED SERVICE DELIVERY MARKET

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Abstract:

There are a lot of benefits of shared service model for any companies using it. Those companies could be successful that have size enough because for example cost-benefits depend on economies of scale. According to SunGard global research in 2010, 54% of companies using shared service centers have 1 billion or more US dollar turnover per a year. Because the larger a company, the larger the likelihood that the company use different separated systems, non-standardized processes. The main benefits of model are available not only in case of big volume exploited but diminishing redundancies.

In this part of my research I am focusing on Central-Eastern Europe region and Hungary to analyze their position on the global service market. I found what are the most tendencies, which countries have good, which have worse positions in the global rankings and what will be in the future. I analyzed the effect of global crisis on the service delivery market and the recovery from it.

Key Words: Service delivery market, shared service organizations, SSO

Introduction

The classic shared-service model was created to achieve savings. It is reached by creating economies of scale and enhancing of efficiency, so delivering services for more and more customers but with the same resources. It was available mostly at the services with high volume and many transactions where it could be minimized the number of interactions with customers. The high number of transactions is important because these functions could be standardized quite well and that is one of the sources for cost-cutting. Beside it the key of the success is process-automatization and technological improvements. It is well prescribed for the workforce employed in the shared service organizations (SSO) in case of different events which process should have to follow. It is called event-management. The work of employees in these organizations is very similar to classic industrial assembly or manufacturing model but interpreted for services. That is why it is called process-driven organization.

The most frequent appearance of the shared service model is captive center that is an organizational unit with the aim to re-manage certain services – that delivered for a broad scale of organizational units – in a specific service center. (Bodnár & Vida, 2006, p. 277)

Captive centers were originally established for getting cost-benefits and lately they were one of the main drivers of offshoring projects. Captive centers deliver internal services exclusively only for units of the parent organization. However there are similar organizational units that deliver services not only for internal units but for external partners, it is called shared service center.

Because the shared service model has a lot of benefits for the companies, more and more company uses the model and these companies find the most appropriate geographical area of their operation. In this market CEE region and Hungary have good position.

The purpose and methodology of the research

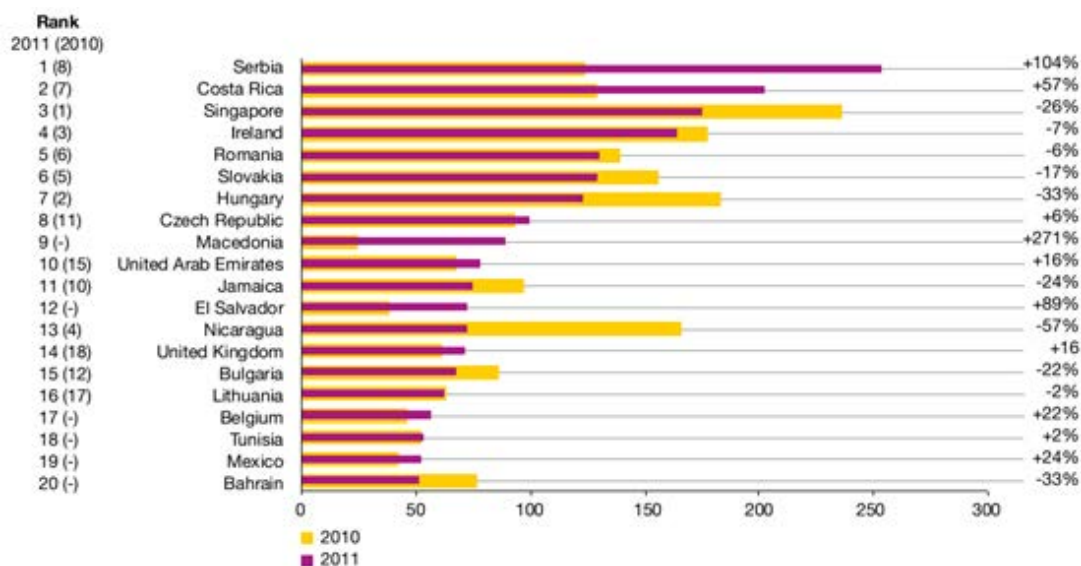
The aim of this research is to explore the position of Central-Eastern Europe and Hungary on the global sourcing market. I analyzed the global service delivery and foreign direct investments rankings to disclose the tendencies of these countries and try to get conclusions from them. The research is based mostly on literature review but there are some own notes and conclusions about it.

Choosing a shared service locations

When investor companies are looking for a location for their shared service center, it is an important question why companies invest in Hungary. They analyze the tax system, labor costs, labor

skills, infrastructure, level of bureaucracy, state of the business culture and standard of living. In establishing a shared service center the most important decision factors are cost optimization options, the available modern 'A' category office space, foreign language proficiency, skilled workforce and the infrastructural, cultural and economic environment.

The availability of suitable workforce covers the state of development of the service sector, the geographical distribution of workforce, labor skills and language proficiency and risk of attrition. The characteristics of the business environment include the Foreign Direct Investment (FDI) ranking of the country, the development of infrastructure, culture and the level of protection of intellectual capital.



1. **Figure:** Top ranking destination countries by estimating jobs - per 100k habitants, Source: (Dencik & Spee, 2012)

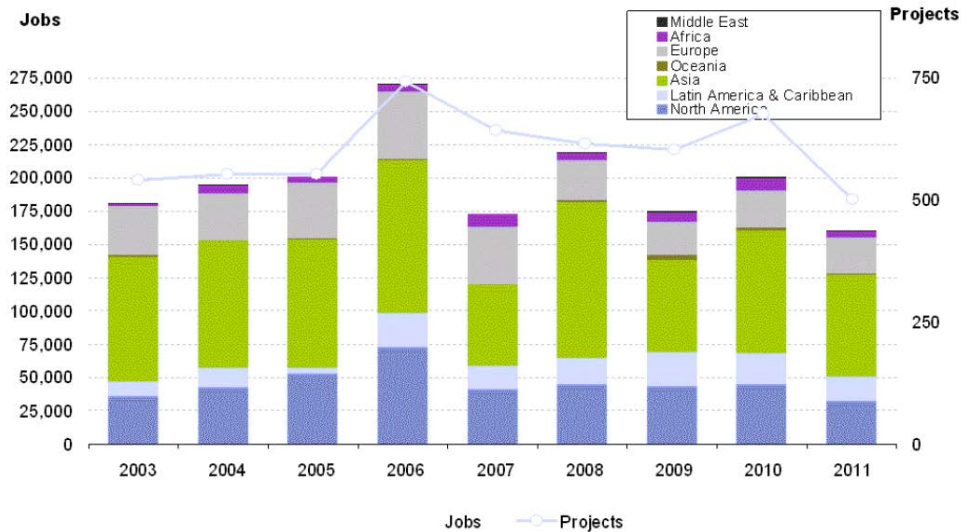
The main competitive advantage of Hungary is that the average salary level is below that in Western European countries. In addition, the low salary level is coupled with a high expertise level in this region and so the companies operating the shared service centers can employ a similarly skilled workforce at a much better price. Not only the salary level is lower but also the other associated costs (office space, training, etc.) are cheaper than in the West-European countries (Nagy, 2010).

Among the many aspects of analysis, all of my interviewees confirmed that the most important decision criterion for investors is the available suitable labor.

Position of cee region in the global service delivery market

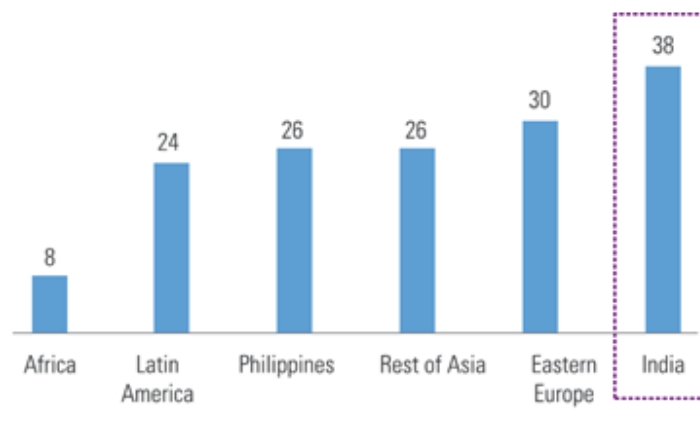
In 2008-2009 emerged global crisis had a very huge negative effect on the foreign direct investments and the global service delivery market as well. (Dencik & Spee, 2012) Albeit after 2009 the market got to normalize but according to the annual IBM market research, the recovery seems to be prolonged and the tendency is confused in short term. (Spee, 2013)

After upturn of 2010, the year of 2011 showed a downturn again and this year was the lowest since 2003. An interesting accompanying of this decreasing tendency is that proportion of domestic shared service centers is increased against of international investments. So Indian companies invested in India rather than in other countries. In 2011 one quarter of the total new SSC investment was this kind and almost 40% of new jobs. The main reason of it was that in the investment market the Asian countries (mainly India, China) had more and more significant role. And companies of these countries invested in new shared service establishment mostly at home.



2. **Figure:** General trends in Shared Service jobs by world region, Source: (Van Hove, 2011)

After 2010, in 2011 Europe got the third position after Asia and North-America in the absolute number of shared service projects. The leading position of Asia is unquestionable. Half of all new position is linked to this continent. North-America got 20% in creating new positions, Europe has a quite similar result but Latin America got only 10%. Middle East and North Africa got only marginal result because of its political changes and instability. (Van Hove, 2011)



3. **Figure:** New service delivery centers established, Source: (Parakala, et al., 2012)

Europe has a stable and well-balanced position in the global service delivery market. This position is stable because the number of new SSC jobs was not decreased and well-balanced because the European SSC jobs are divided half-by-half between West-Europe and Central-Eastern Europe. (Van Hove, 2011)

Shared service competition within cee region

There is a very high competition in the CEE region for attracting new Shared Service Centers. Within the regional competition the most important term of establishing shared service centers in Hungary was the early 2000's. Compared to the regional competitor countries the advantage of Hungary was not the foreign language skills – though it has rare European language speaking young workforce – but from the research of the EU public research agency, the Eurobarometer released its 2001 study, Hungary is quite weak in foreign language speaking.

The attraction was rather the good regional conditions, the close geographical lying to the West European countries and had almost unlimited amounts of skilled labor that cost was half than in the West but twice as much than in India. (Erdős, 2005) Since then the cost of labor is emerging year-

by-year in the region. This closing up to the level of West-Europe's cost stimulates the leaders of service centers to improve their efficiency indices. (Thorniley, 2003)

Over the last decade rapid growth the business service industry and within the shared service sector outgrown itself and became one of the key segments of service industries and the major employer in the country. Today, there are more than 80 shared service centers in Hungary, that primarily employ foreign language speaking, educated workforce with about 40.000 employees. (Sütő, 2012)

The shared service centers provide a range of business services – most notably in finance, accounting, procurement, logistics, information technology and human resources area – mostly in regional and sometimes in globally. Besides this sector is a major employer, around 1.2% of state budget came from taxes on it in 2010.

The key question is that a parent company why chooses Hungary when looking for an investment location to establish a new service center. To win this competition Hungary has to prove that the society is cosmopolitan, capable of operating international level, young people speak several languages and well-educated. But there is a serious responsibility on government and the leaders of local government. If cities have close, well-equipped offices and public transport infrastructures then it could mean a high attraction. At such a decision about 40-50 countries compete on a list.

Several consulting firms make rankings that can help in choosing an investment location. Perhaps one of the most famous lists is the A.T. Kearney annually compiled Global Services Location Index (GSLI), that ranking the most favor 50 countries on the base of service sourcing. Three aspects took into account in the methodology of ranking: financial attraction of the county (40%), the availability of adequate human resources and training (30%), and the business environment (30%). The first ranking was in 2004 and since then the first three countries are India, China and Malaysia. Position of Hungary is continually changing but it was constantly in the first 40 countries. Unfortunately within Central and Eastern Europe Hungary is not too competitive.

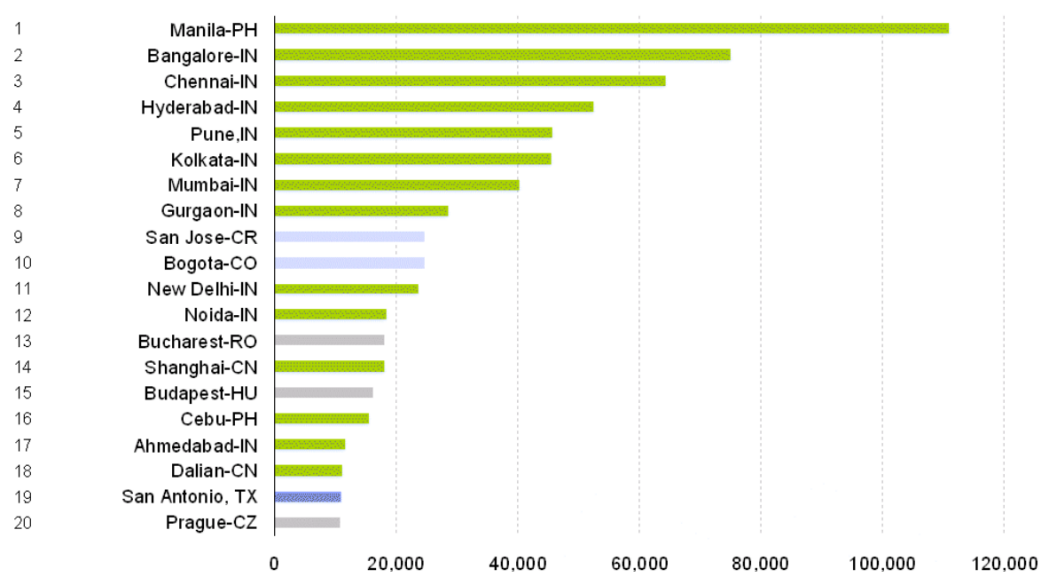
Unfortunately, in recent ten years Hungary has completely sidelined in the first 10-20 positions, as the same has happened with the Czech Republic, Poland and Slovakia. Although the business service sector has been growing during this term.

However the position of the Baltic countries (Latvia, Lithuania and Estonia) has significantly strengthened but the judgment of Romania and Bulgaria also improved a lot. So these countries are the he major competitors of Hungary now. It is true that more Asian countries overtook Hungary on the global service market but for example the world-leader India is not competitive because companies choose India for one purpose and Central and Eastern Europe for another. In India there are such services that are like to mass production and do not need special skills. On the global service market it contributes to the position-losing of Central and Eastern European countries the fact that Middle-East and North-Africa has also appeared among the most popular locations. The reason of their uprising is based on the large and educated population and proximity of Europe.

Hungary's biggest competitive advantage is that labor cost is still lower than West-European. This has reinforced the fact that low labor costs are coupled with higher expertise and the investor company could get workforce similar to West-European but at lowest price. And not only the labor costs are lower but the other incremental costs (training, office, etc.) are also cheaper. (Nagy, 2010)

But the risk of continuous growth of labor costs is modulated by the fact that Central and Eastern Europe should not compete with the Far East. Those countries that contend in this competition only with their cheapness of workforce could not win in the long term. If countries want to stimulate investments, they have to aspire added-value creation because the educated, skilled, languages-speaking workforce is more valuable. So in the attraction and retention of service centers will be successful those countries that undertake not for low added-value, transactional work but focusing on more difficult, knowledge-based tasks. Reaching this country and regions have to invest in developing education and training.

If we see the ranking of global service delivery cities, there is very high advantage for Indian cities in the top ten but other Asian cities are also well-positioned in this ranking.



4. Figure: Top ranking SSC agglomerations by estimating jobs, Source: (Van Hove, 2011)

Among the European cities the first is Bucharest with its 13th rank, then the second is Budapest with its 15th rank and Prague is on the 20th rank.

Romania has very good position in the SSC cities ranking because besides Bucharest there is Cluj-Napoca also on the list. The two most promising countries were in Europe in 2011 Turkey and Serbia. (Van Hove, 2011)

Conclusion

As in every country in the Central-Eastern region, the development of the shared service sector plays an increasingly important role in the growth of the Hungarian economy as well. Between 2005 and 2010 this sector showed the largest growth, an annual 20% on the national level. In the CEE region and in Hungary the salary level, geographical proximity, cultural homogeneity and the development of infrastructure attract investor companies. Mostly 'mass-production', highly standardized business services requiring mainly secondary-school-educated labor has migrated to Hungary (NFM, 2010).

As a result of the last ten attractive years, today there are more than 80 shared service centers in Hungary and the vast majority of them are operating as subsidiaries of large international companies. Naturally the largest Hungarian companies (mainly regional multinational companies and state-owned companies) also have similar service centers, but their number is much lower than that of the subsidiaries of foreign investors.

Because of this sector has a great effect on the national economies in this region, it is sure that competition will continue among these countries to attract new investments and play important role in the global service delivery market. The Hungarian government has the duty to highlight the results, strengthen the efforts and support the sector.

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FOREIGN DIRECT INVESTMENT FLOWS IN THE PERIOD OF WORLD ECONOMIC CRISIS

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Abstract:

The core of this article is to study the impact of the last world financial crisis on the same period world foreign direct investment fluctuations. As last World Investment Report (WIR 2012) appear the current world financial crisis involved in the foreign direct investment flows drop. That was characteristic for the EU economy, too. The main reasons of that are the descending investment capability of corporations, because of poorer profits level and higher costs of bank credits. The important argument for corporation investment slump, is that the perspective of world economic growth are unfavourable.

Key Words: FDI, FDI flows, economic crisis

Introduction

A characteristic feature of the world economy is deepening its internationalization process and the transition to a higher stage of globalization. This is an increase, and also the intensity of economic links between countries, regions and companies (Rymarczyk, 2004). The existence of numerous and often very strong ties in the world makes it all appear "turbulence" in particular the nature of the economy of the country can easily move to another.

The result of the internationalization of economic fluctuations is also spreading in the world of its effects on the real economy. One of the most important is to cut down the processes of investment in the economy. This is on the one hand the effect of gradual decrease in liquidity of enterprises, as a result of increasing commitments and the need to repay debt in the face of declining market demand. The result of the current financial problems of companies is freezing strategic decisions, such as for the implementation of planned investments. It can therefore be concluded that international capital flows in the form of foreign direct investment can be a transmission channel of cyclical fluctuations.

The purpose of this article is to evaluate the relationship between capital inflows in the form of foreign direct investment, and the economic situation, expressed by the fluctuation of GDP. The time horizon of the analysis covers the period of world economic crisis (2006-2012). The analysis of empirical study is based on the data published by UNCTAD in annual reports "World Investment Report".

Global foreign direct investment (FDI) flows exceeded the pre-crisis average in 2011, reaching \$1.5 trillion despite turmoil in the global economy. However, they still remained some 23 per cent below their 2007 peak. It is predicted slower FDI growth in 2012, with flows levelling off at about \$1.6 trillion (WIR 2012). Leading indicators – the value of cross-border mergers and acquisitions (M&As) and greenfield investments – retreated in the first five months of 2012. Longer-term projections show a moderate but steady rise, with global FDI reaching \$1.8 trillion in 2013 and \$1.9 trillion in 2014, barring any macroeconomic shocks.

FDI inflows increased across all major economic groupings in 2011. Flows to developed countries increased by 21 per cent, to \$748 billion. In developing countries FDI increased by 11 per cent, reaching a record \$684 billion. FDI in the transition economies increased by 25 per cent to \$92 billion. Developing and transition economies respectively accounted for 45 per cent and 6 per cent of global FDI. UNCTAD's projections show these countries maintaining their high levels of investment over the next three years.

Literature review

Foreign direct investment is a kind of capital flows, that finance domestic investment especially for the countries that don't have enough capital. It also contributes to high level technology import and promotes advanced management and consequently stimulates the growth. In the literature it is proved, that the economic growth increases not only by accumulating capital but also through high efficiency of this form of investment (Borensztein et al., 1995). Also, Rana and Dowling (1988) have pointed out that foreign capital inflows and export are two important determinants that explain economic performance. They believe that FDI facilitates technology transfer and consequently increases capital efficiency and the growth. According to Wang and Blomström (1992) the influence of FDI on the growth depends positively on the substitution of domestic and foreign technologies and educational level in home country.

According to exogenous economic growth theories, capital has an important effect on economic growth. Based on these theories, FDI can increase the growth only in short run, but the economic growth in the long run is influenced by the labor and technology growth. Regarding to some deficiencies in these models especially on the assumption of constant rate of technological progress and diminishing marginal return of capital and after 1980s, endogenous growth theories assume technology as endogenous factor.

In this framework, it seems that FDI has higher efficiency than domestic investment. Specifically, these theories with emphasizing on some factors driving growth such as human capital, externalities and spillovers provide some grounds for FDI affecting on the growth (Grossman, Helpman, 1991, Loungani, Razin, 2001). Also, according to endogenous growth theories, FDI absorbed through transferring technology brings out productivity spillovers and consequently increases the growth.

International capital flows in the form of FDI and the state of the global economy

The period from the last decade of the XX century was characterized by a significant increase in the dynamics of global capital flows. This applies to both portfolio investment and direct investment. The acceleration of international capital flows was the result of the growing diversity of economic growth in different regions of the world. Another reason was the progress in the liberalization of international capital flows.

In the period 1991-2000 the growth rate of FDI flows surpassed the global average GDP growth. As shown in Table 1, the share of FDI flows to GDP has increased significantly during the analyzed period from 0.68 per cent in 1991 to 4.31 percent in 2000. The highest level of 1998-1999 global FDI flows reached an increase in scale of 42% (1998) and 57% (1999) year to year. In 2000, the growth rate of world FDI flows moderated somewhat and reached 29%, but still significantly higher than the corresponding changes in the value of world GDP.

Global GDP growth in the 90s was also among the highest in the last 50 years. It resulted from the dynamic development of the world's largest economy - the United States. The great importance also had record economic growth of South-East Asia and Central-Eastern Europe countries. These regions were one of the most penetrated by foreign capital in the form of FDI.

The twenty first century began with the crisis in the global economy. It was caused in the U.S. economy, and became known as "dot-com crisis" because it concerned the sharp declines in stock the largest American companies of the IT sector. Unfounded belief in not submitting of IT sector to the business fluctuations, caused discrepancy between the value of the market share and real ability to generate profits. Finally, after a peak level price of IT companies, the market value of its shares sharply dropped in the stock market.

Table 1. The global GDP value and FDI stock and flow in the period of 1990 - 2013 (in billions of USD, current prices)

PERIOD	GDP	FDI STOCK	SHARE IN GDP (%)	FDI FLOWS	SHARE IN GDP (%)
1990	22185,3	210,3	0,9	210,3	1,0
1991	23261,5	369,3	1,6	158,9	0,7
1992	24344,0	545,1	2,2	175,8	0,7
1993	24984,4	764,5	3,1	219,4	0,9
1994	26808,5	1020,5	3,8	256,0	1,0

1995	29799,1	1351,6	4,5	331,1	1,1
1996	30521,0	1737,7	5,7	386,1	1,3
1997	30388,4	2219,6	7,3	481,9	1,6
1998	30171,6	2905,7	9,6	686,0	2,3
1999	31348,2	3984,8	12,7	1079,1	3,4
2000	32306,2	5377,7	16,6	1393,0	4,3
2001	32099,7	6201,5	19,3	823,8	2,6
2002	33354,7	6852,7	20,5	651,2	2,0
2003	37493,9	7410,6	19,8	557,9	1,5
2004	42177,5	8121,4	19,3	710,8	1,7
2005	45615,6	9080,0	19,9	958,7	2,1
2006	49375,2	10543,4	21,4	1463,4	3,0
2007	55718,2	12518,9	22,5	1975,5	3,6
2008	61221,6	14309,6	23,4	1790,7	2,9
2009	57846,2	15507,5	26,8	1197,8	2,1
2010	63179,6	16816,5	26,6	1309,0	2,1
2011	69899,2	18340,9	26,2	1524,4	2,2
2012	71277,4	19940,9	28,0	1600,0	2,2
2013	74148,6	21740,9	29,3	1800,0*	2,4

*UNCTAD forecast

Source: Own research based on: http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf

The second event that contributed to the coming recession in the U.S., was terrorist attacks in the U.S. in 2001. Despite that fact had no direct impact on the state of the U.S. economy, it contributed to maintain the financial crisis, started in 2000, as well as in the other developed economies of the world.

The negative effect of rapid cyclical impulses spread in the world economy, resulted from the liberalization of capital flows. It also revealed during the recent financial crisis, which started in 2007. The immediate cause of the recent collapse in the U.S. economy, was the situation in the mortgage loans, i.e. subprime loans. The increase in the share of such assets in the portfolios of the banks did not have a negative impact on their financial situation, to the point where real estate prices grew up.

The collapse of house prices in the United States led to the bankruptcy many of financial institutions, as well as the transfer the profits from subsidiaries located in the other countries to parent companies. A similar mechanism for the spread of the crisis, was the situation of the banking systems of Great Britain and Spain.

Table 2. Value of FDI stock by the EU country (in millions of USD)

Country	1990		2000		2011	
	761820	100,0	2323505	100,0	7275622	100,0
Austria	10972	1,4	31165	1,3	148799	2,0
Belgium and Luxembourg	58388	7,7	195219	8,4	957836	13,2
Bulgaria	112	0,0	2704	0,1	47653	0,7
Cyprus	-	0,0	2846	0,1	16398	0,2
Czech Republic	1363	0,2	21644	0,9	125245	1,7
Denmark	9192	1,2	73574	3,2	152847	2,1
Estonia	-	0,0	2645	0,1	16727	0,2
Finland	5132	0,7	24273	1,0	82962	1,1
France	97814	12,8	390953	16,8	963792	13,2
Germany	111231	14,6	271613	11,7	713706	9,8
Greece	5681	0,7	14113	0,6	27433	0,4
Hungary	570	0,1	22870	1,0	84447	1,2
Ireland	37989	5,0	127089	5,5	243484	3,3

Italy	59998	7,9	122533	5,3	332664	4,6
Latvia	-	0,0	2084	0,1	12109	0,2
Lithuania	-	0,0	2334	0,1	13921	0,2
Malta	465	0,1	2263	0,1	16706	0,2
Netherlands	68701	9,0	243733	10,5	589051	8,1
Poland	109	0,0	34227	1,5	197538	2,7
Portugal	10571	1,4	32043	1,4	109034	1,5
Romania	-	0,0	6953	0,3	70328	1,0
Slovakia	282	0,0	4762	0,2	51293	0,7
Slovenia	1643	0,2	2893	0,1	15145	0,2
Spain	65916	8,7	156348	6,7	634532	8,7
Sweden	12636	1,7	93995	4,0	338484	4,7
United Kingdom	203905	26,8	438631	18,9	1198870	16,5

Source: Own research based on: http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf

By analyzing the structure of FDI stock in the EU, it can be seen significant changes in this area. Among the so-called old EU members, the largest share in the total stock of FDI in the EU has the United Kingdom (16.5%), Belgium with Luxembourg (13.2%) and France (13.2%). Provided, however, the share of Great Britain in the analyzed period decreased by 10 points, the share of France increased slightly by 0.5 points, the share of Belgium and Luxembourg increased nearly 6 points. Such a significant increase in the case of Belgium and Luxembourg resulted from considerable transfers of capital from other countries to Luxembourg, which is known as a tax haven.

Table 3. Value of FDI flows by the EU country (in millions of USD)

Country	2006	2007	2008	2009	2010	2011	Average annual growth rate 06-11 (previous year=100)	Grow rate in 2011 2007 = 100
EU Total	585030	853966	542242	356631	318277	420715	99,3	49,3
Austria	7933	31154	6858	9303	4265	14128	185,5	45,3
Belgium	58893	93429	193950	61744	81190	89142	127,9	95,4
Bulgaria	7805	12389	9855	3385	1601	1864	87,3	15,0
Cyprus	1834	2226	1415	3472	766	276	97,7	12,4
Czech Republic	5463	10444	6451	2927	6141	5405	119,2	51,8
Denmark	2691	11812	1824	3917	-7397	14771	56,1	125,1
Estonia	1797	2716	1729	1839	1540	257	84,3	9,5
Finland	7652	12451	-1144	398	6733	54	362,2	0,4
France	71848	96221	64184	24219	30638	40945	99,7	42,6
Germany	55626	80208	8109	24156	46860	40402	146,5	50,4
Greece	5355	2111	4499	2436	373	1823	162,1	86,4
Hungary	6818	3951	6325	2048	2274	4698	113,6	118,9
Ireland	-5542	24707	-16453	25960	26330	13102	-103,8	53,0
Italy	42581	43849	-10835	20077	9187	29059	51,0	66,3
Latvia	1663	2322	1261	94	379	1562	203,3	67,3
Lithuania	1817	2015	1965	66	753	1217	302,9	60,4
Luxembourg	31837	-28260	11216	22408	9211	17530	60,6	-62,0
Malta	1838	805	802	746	1063	539	85,9	67,0
Netherlands	13978	19383	4549	36042	-8966	17129	147,7	88,4
Poland	19603	23561	14839	12932	8858	15139	101,9	64,3
Portugal	10908	3063	4665	2706	2646	10344	145,4	337,7

Romania	11367	9921	13909	4844	2940	2670	82,8	26,9
Slovakia	4693	3581	4687	-6	526	2143	-1630,4	59,8
Slovenia	644	1514	1947	-653	359	999	110,7	66,0
Spain	30802	64264	76993	10408	40761	29476	161,2	45,9
Sweden	28941	27737	37153	10023	-1347	12091	-130,9	43,6
United Kingdom	156186	196390	91489	71140	50604	53949	85,6	27,5

Source: Own research based on: http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf

For the contrast, the share of German's economy is relatively low (the decrease from 14.8% in 1990 to 9.8% in 2011) – in the context of the GDP share. German economy – the largest among the EU countries, is a major exporter of capital in the form of FDI. On the other hand, due to high level of labour costs, German companies transfer production to the other countries, such as Poland, the Czech Republic, and Slovakia, where labor costs are lower. The other countries with a significant share of the total stock of FDI in the EU are: Spain (8.7%), the Netherlands (8.1%) and Italy (4.6%). Share of Spain during the period remained unchanged, while the participation of the Netherlands fell by 0.9 percentage point, Italy dropped by 3.3 percentage points.

Against the background of the old members of the EU, the share of the Central European countries, is relatively small. The highest share of FDI stocks among the new EU members are: Poland (2.7%), Czech Republic (1.7%) and Hungary (1.2%). The other countries participate in total EU FDI by less than 1 percent.

The analysis of FDI flows in the years 2006 – 2011 (Table 3) indicates the diversity of variation in this respect. The least sensitive FDI variations caused by business cycles were observed in the countries that have large and diverse economy. These countries noted an positive average growth of FDI in the year of 2006-2011. Smaller countries, which have less diversified economies, often noted a negative balance of FDI. But the greatest fluctuations in FDI flows were characterized by countries, dominated by direct financial investments (Luxembourg, Ireland, Cyprus). The relative ease of their withdrawal makes the scale of such flows is significant.

Reference value of FDI in 2011 compared to the value of 2007, shows that most countries have not yet managed to regain pre-crisis levels of direct investment. The exceptions in this regard are: Denmark, Hungary and Portugal. Denmark as a non-member of the euro zone, had no problems related to the euro zone crisis. With regard to Hungary and Portugal, the highest value of FDI inflows were noted in 2006, and due to this fact in 2007 there was observed a significant decline in FDI inflow. Most countries reached the level of FDI, that varies between 40-70%, while economies that are tax havens show a slight increase (Cyprus) and the relative decline of FDI (Luxembourg).

The decline in economic activity associated with the global financial crisis has caused not only a decrease in the value of FDI flows in the world. The deterioration in financial performance, higher requirements for companies to obtain a bank loan and a negative assessment of the prospects of development, led the multinational companies reduced investment projects in the form of greenfield investments. There was also a decline in the value of brownfield investments, focusing on cross-border mergers and acquisitions in existing entities.

During the economic and financial crisis, the global value of greenfield investment projects fell in 2011 by 45% compared to a record in 2008. The share of EU countries in the total value of greenfield investment projects in the world declined in the same period by 50%. In the analyzed period, one of five U.S. dollars spent on this type of investment was invested in the area of EU countries. Although declines took place in all the EU countries, there are significant differences at the level of countries surveyed.

Table 4. Value of greenfield FDI project by country of destination (in millions of USD)

Country	2006	2007	2008	2009	2010	2011	Average annual growth rate 06-11 (previous year=100)	Grow rate in 2011 2007 = 100
EU Total	228029	229275	332341	197220	162541	167295	98,0	73,0
Austria	2096	3166	3028	1717	2289	4123	123,4	130,2
Belgium	4936	10519	10797	3796	6060	3121	112,4	29,7
Bulgaria	19330	7695	11422	4780	4780	5300	88,2	68,9
Cyprus	390	465	629	249	720	385	127,3	82,8
Czech Republic	7677	7491	5684	4575	7733	4910	97,3	65,5
Denmark	1697	2047	1968	2195	457	780	104,0	38,1
Estonia	954	840	1481	1260	947	883	103,6	105,1
Finland	1797	1269	2415	1208	1661	2180	115,9	171,8
France	18554	19435	24349	11410	9140	10569	94,5	54,4
Germany	18028	18563	36871	20039	17108	15325	106,2	82,6
Greece	1706	5096	5278	2090	1123	2372	141,4	46,5
Hungary	8784	9550	9003	4665	7566	3212	91,9	33,6
Ireland	6575	4680	8265	4948	4487	7020	111,0	150,0
Italy	11710	11915	14513	10501	11366	5623	90,7	47,2
Latvia	3248	717	2550	828	965	717	120,2	100,0
Lithuania	1306	1485	1518	1232	1558	7285	178,2	490,6
Luxembourg	228	685	431	759	731	290	135,1	42,3
Malta	880	299	395	467	300	174	81,3	58,2
Netherlands	4942	5828	9438	9459	10959	5620	109,4	96,4
Poland	15651	22803	35208	14548	11446	12620	106,1	55,3
Portugal	4381	10945	7763	4932	2665	1701	100,4	15,5
Romania	19251	21959	32596	15019	7774	16188	113,7	73,7
Slovakia	11557	5485	3350	5382	4242	5676	96,4	103,5
Slovenia	657	1037	612	282	748	658	123,2	63,5
Spain	21157	23589	31572	15993	16372	11343	93,5	48,1
Sweden	7037	4391	2982	2879	2364	3081	87,9	70,2
United	33500	27321	68224	52008	26983	36140	118,7	132,3

Source: Own research based on: http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf

Countries with a high share of the EU greenfield projects, did not reached the level of investment in 2007 yet. Significant growth rate, that is observed in some of the EU members, resulted from the low absolute value of those kind of investments, and a small share of the whole EU greenfield FDI. Other countries i.e. tax havens are not typical regions of interest for greenfield investments.

The second component of capital flows in the form of FDI, are brownfield investments. This is the case of purchase of all or a part of shares in existing enterprises, in order to gain management control. Although, paradoxically, the crisis should encourage restructuring processes and the search for new, more effective solutions, in 2007-2008, fewer transnational corporations were engaged in the development of new projects. This was true both for investments seeking new markets, as well as targeted investments in new resources.

Table 5. Value of brownfield FDI project by country of destination (in millions of USD)

Country	2006	2007	2008	2009	2010	2011	Average annual growth rate 06-11 (previous year=100)	Grow rate in 2011 2007 = 100
EU Total	333337	527718	251169	116226	115974	172257	500,5	32,6
Austria	1145	9661	1327	1797	432	6928	2620,7	71,7
Belgium	1794	961	2491	12089	9444	3920	917,7	407,9
Bulgaria	807	971	227	151	24	-96	-173,9	-9,9
Cyprus	294	1343	-909	52	680	780	1805,8	58,1
Czech Republic	1154	107	5169	2669	-457	725	4716,0	677,6
Denmark	11235	5761	6095	1651	1448	7659	800,8	132,9
Estonia	3	-57	110	28	3	239	5909,9	-419,3
Finland	1321	8313	1153	508	324	973	1051,3	11,7
France	19423	28207	4590	724	3837	24325	1341,2	86,2
Germany	41388	44091	31911	12790	8507	12709	434,9	28,8
Greece	7309	723	6903	477	-819	1205	652,7	166,7
Hungary	2337	721	1559	1853	213	1714	1182,1	237,7
Ireland	2731	811	2892	1712	2127	2181	672,3	268,9
Italy	25760	23630	-2377	1109	6329	13450	818,2	56,9
Latvia	11	47	195	109	72	2	966,9	4,3
Lithuania	97	35	98	20	462	386	2730,0	1102,9
Luxembourg	35005	7339	-3570	444	5446	9393	1358,9	128,0
Malta	517	-86	0	13	315	0	2391,3	0,0
Netherlands	25560	162770	-8156	17988	4113	14031	775,3	8,6
Poland	773	728	966	776	1063	10043	1389,0	1379,5
Portugal	537	1715	-1279	504	2208	911	684,7	53,1
Romania	5324	1926	993	314	148	88	225,9	4,6
Slovakia	194	50	136	13	0	0	307,3	0,0
Slovenia	15	57	418	0	332	51	1208,1	89,5
Spain	7951	51686	33708	32173	8669	17298	1037,2	33,5
Sweden	15228	4563	18770	1098	221	7616	3913,4	166,9
United Kingdom	125421	171646	147748	25164	60833	35691	540,4	20,8

Source: Own research based on: http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf

Decrease in brownfield investment respected mainly to the developed countries. Among the reasons for this, in addition to the previously mentioned financial and credit constraints, it can be indicated the high risk of such ventures and poor perspectives for economic growth in the world.

The effect of drop of liquidity in some of transnational corporations was to transfer the capital from one subsidiaries, that appear financial surplus, to the other, that had the losses. In 2007-2009, up from reinvestment of profits, there have been significant divestments, and the withdrawal of capital, combined with the restructuring and closing the least profitable subsidiaries and affiliates.

In the years 2006 - 2011 the value of global mergers and acquisitions decreased by 16%, while in 2007 the value was almost twice higher than of 2011. The brownfield investments made on the EU area decreased by 67% in 2011, compared to 2007. In relation to the previous researched year, there was drop of 48%.

Conclusion

The world economic and financial crisis, which started in 2007, also reflected in international capital flows in the form of FDI. Global FDI flows declined by 23% compared to the 2007 peak level. In the comparable period in the EU, FDI inflows have been reduced by as much as 49.2%. In 2011 the value of FDI inflows to the EU countries accounted for only one-quarter of global FDI flows, while in 2007, it was up 43.2%. This means that EU countries gradually cease to be the dominant area of global FDI inflows. Dominant share in global FDI flows take developing and transition countries.

Analysis of the geographical structure of capital flows in the form of FDI may lead to the conclusion, that gradually decreases the share of old EU member states in favor of the new EU member states, which have lower labor costs and a highly educated workforce. It can be also seen a significant inflow of FDI to the so-called tax havens (Luxembourg, Cyprus).

With regard to the distribution of FDI in greenfield and brownfield projects, it is found a greater share of the brownfield form, as well as the greater range of variation of brownfield investments during the economic and financial crisis. It is the result of companies to adapt to market recovery resulting from the expected arrival of business prosperity phase.

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THE SUBJECT OF PRODUCTION IN A GLOBALIZED WORLD

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Abstract:

Capitalism is the social production that takes place in private economic units and the contradiction between social and private is resolved by private exchange of goods. Capital, over all, is the manifestation of a social relationship, the disobedience of which manifests itself through the continuous mobility under two aspects: functional transformations, and spatial movements.

With the State, exceeded, the articulation of the productive relationship in every point of the economically defined space can interpret the shift from past macroeconomic equilibrium of the national area to the pulse of the open beam free world goods which corresponds to a direct productive meeting between the capital and labor.

Developments in both credit and productive field equivalent to an autonomous operation of capitalist relations prepared by the internationalization of the State, and create flexible boundaries that allow potential labor participation in profits.

The modern social Meta – organization, selects money as a reflection of the relationship developed in each field of the production of value. As it relativizes the space, this field extends beyond the limits of traditional production relations that are articulated within the place.

Key Words: Capital, labor, money, value, Meta – national

Introduction

This text examines the behavior of the subjects of production in the context of the globalization of capitalism. The aim is to demonstrate that the system as a whole relativizes the space and the exceeding of the State highlights new independent reproductive mechanisms. The interesting thing is to see the affirmative clues towards a world where adoptive behaviors, former institutional, are attending as a term of the new productive relationship in the Ecumenical field.

General characteristics, developments in the organization of production

Capitalism is the social production that takes place in private economic units and the contradiction between social and private is resolved by private exchange of goods: the spending (built-in) work for their production is certified and socially assessed; the owner of the product achieves a claim to an equivalent part of social work in another unit that is produced within the social division of labor.

This "recognition" is done through institutions and mainly through the institution of money, the universal equivalent of which each producer assesses the part of social work that holds or claim against the exchange.

The decisions of economic units are taking place in a field of accumulation and reproduction that the systematic distribution and redistribution of the productive result of each time, is done by social coordination of the conditions of production and of final consumption (appropriate allocations between total supply and total demand).

The relativity of the space

To the economically acting the following degree of freedom is "awarded", followed by their alienation of the means of production, as aptly put by Hegel, (teste, Ferreira-Ege, 1998, pp. 586-587): the subject may sell to another a particular product of physical and mental skills and potential actions or even their hiring for a limited time because it is this restriction that develops an external relationship, outside the unity and universality of each subject of production. This encapsulates the differentiation of capitalism than earlier systems, which exchanged the man as a productive unit, and not his work, and there was no formal marketing freedom of Worker.

But with the release of labor occurs and the liberation of the capital from this job, the static, almost unchanged nature of a relationship that could be structured in capitalism's previous formations.

At the same time, the capital, over all, is the manifestation of a social relationship, disobedience of which manifests itself through the continuous mobility under two aspects:

a. Functional Transformations of productive capital, in commodity capital, in financial capital.

b. Spatial movements in the search of the means of its self-expansion.

Consequently, the importance of space is becoming relativized. The capital moves with increasing ease and is associated with labor with typical production functions for each period (Marx K. *Capital*, [Greek translation] 1978 Vol.2, Ch. I, II, III).

The absolute relativity of space is manifested in the money form of capital (Holloway J. 1990, 1992.).

In an imaginative figure, a Baechler's continuum (Baechler J. 1995, p. 77), on one pole it is integrated producer and consumer in the same person (consumes only what it produces and only produces what it consumes). On the other pole that represents an absolute market, everyone consumes what has been produced exclusively from others (from the most complex products to the most simple services), and produces exclusively for others (absolute specialization and Division of work extended to the absolute end of).

In the never-ending process of the historical succession, as markets expand, the Division becomes deepening and the transactions become more impersonal, the mutual trust must be institutionalized in a peculiar way: each institutional past behavior tends to become "second nature" of the subject of production and consumption. Under this perspective, the market society dissolves the traditional community, and at a higher abstractive level flows toward the universal market society without external relations that stimulated the economic behavior.

National and Meta - national paradigm (Universal, Meta - state schematic form)

On the domestic (national) pattern, institutional mechanisms had been created so as balances maintained when excessive savings occurred, the total demand amounted with labor's responsibility or the excessive consumption of capitalists caused risks of imbalance.

Things go in a further self-regulated financial status: direct contact between labor and capital can be effectively interpreted only if the epistemological field moves in the relationship between values, General and indeterminable exchange value from the perspective of capital and General and indeterminable use value from the side of work.

With the State, exceeded, the Commodity contract relationship can be potentially articulated at each point of space by reducing losses and the gaps between production and consumption of goods. It is this dematerialization manifested in increasing financial flows and the virtual capital, which are an expression of the developed networks, through which the funds are allocated to its productive use.

And as it is not a dilettante copy of transition, a single metathesis of earlier relationships between capital and labor that matured in the national arena, the relationship is now imposed by its own new terms, the institutional and organizational arrangements.

The "freedom" of the State, the Keynesian space policy, to produce money (through the guarantee of the operation in the movement of money), to strengthen, through market signals and traffic, production in necessary areas within the framework of national, has been limited.

The State does not distribute funds to prospective incomers. This operation shrinks because the same signals "produced" through the state freedom undermined it; as the operation and the nature of money in production and circulation were ignored.

The crisis of the modern State and the "anti-providence revolution" are associated with this exactly ineluctable transcendence of the role of money as capital. Money as capital to be reproduced is suffocated within the framework of the national area.

With the universal spread of capital relationship, of the production and reproduction system, the value that must be tapped because it just exists (capital, money as capital), recourse to special value of utilization (the power of live work) more easily: this is the meaning of universalization.

The work meets most directly itself, its alter ego in the enduring agony to be actualized in a continuing way. All this is done under the new conditions of capital relationship and a new relativity that came with it.

The Ecumenical society of individuals with its new features and its contributors develops as the Adventure follows a lasting to the quest for profitability. The withdrawn State -its removal of direct productive field and "anti-providence revolution"- (Skidelsky R. 1997) partially purify the landscape from the burdens imposed by it (of the ways formation and distribution of value and surplus value were occurred). Sovereignty being eroded, State activity fits organically into a system which is also held at new synapses.

The new productive relationship

The new productive relationship is not anymore the correlation with public policies that guide the development of business investment activities. It is mainly and decisively the very effective self-organization of the firm through productive, financial and communications networks that develop and enable the relations of control and power to determine in what ways the funding, materials and labor contributions are distributed and enter the productive chain.

The venture capitalist and the modern administration are entities which form an autonomous system within a system without rules (Habermas j. teste Coutrot Th. 1998, p. 130).

The articulation of the productive relationship in every point of the economically defined space can interpret the shift from past macroeconomic equilibrium of the national area (investment-consumption relationship, national fiscal and monetary policy, national production function etc.) to the pulse of the open beam free world goods which corresponds to a direct productive meeting between the capital and labor (Cohen E. 1998).

We do not have any more a closed economic system modeled on the "national" past, in order to calculate the GNP financial contributions each coefficient in the generation of income and the creation of wealth. In our opinion, the thought of capitalist production relationship adequately analyzed only through inductive switch in the root system of the mode of production values, through returning to the heart of production values, which is the term for the calculation of the shares in the production output.

The modern subject as a producer and consumer

Developments in both credit and productive field equivalent to an autonomous operation of capitalist relations, prepared by the internationalization of the State, and create flexible boundaries that allow potential labor participation in profits. But it is Labor's participation as "holder" and potential income proprietor. The participative cracks in the system allow growing social property alienated phenomena within the strict framework of the capitalist system, reproduced in an enlarged consensual basis. The possibility of this participation, however, only occurs when an Act doesn't exits of capital, when breeding "respects" the conditions of reproduction of the capitalist system. Labor that owns asset titles that allude to the possession of the means of production, works with capital reproductive terms: not accounting the odds as disposable income for consumption-which will disrupt the overall reproduction of the system-but as a capital that must be constantly in the process of exploitation enters. It is sui generis "capitalist" work mode; otherwise it will not reproduce the system. Treats whatever goodwill comes into its possession as a basis of the reproduction of capital.

Conclusion

The path travelled we saw that the State as an institution of collective consciousness, is removed from the scene and a new mechanism for closer productive communication, emerges, accompanied by the ever cultivated trend for generalized investment behavior of the productive subjects.

The subject grows on the cross-flows of production and circulation which reproduce individually. These are "flows" and patterns of reproduction and evolution of world standards which allow for the realization the modern productive and consuming subject.

The realization of the subject in both, the productive and the consuming field, is taking place in a Meta –space of sharing of its ability to produce in the continuity.

The mediation is carried out by the money through which tends to run any kind of relationship and exchange the result of each individual and collective activity of the subject. Money, whose character is not a mere reflection of the values generated in production but becomes a flexible

autonomous institution ever that now represents a complex Web flows and potential utilization of any present or possible future value. Only within this money (attention: money as capital), the present is represented and the future is mirrored.

The modern social Meta – organization, selects money as a reflection of the relationship developed in each field of the production of value. As it relativizes the space, this field is extending beyond the limits of traditional production relations articulated within the place. Tends to include any activity through which the subject proves its existence.

Money disclaims a single, mere character of the measurement mean of value and becomes the draining channel as each entity endowed with value (as holder of the ability to produce), works now as owner of capital to be invested.

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DYNAMIC CAPABILITIES - ARE THEY PROFITABLE?

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Abstract:

The consequences of dynamic capabilities (i.e. innovation performance and profitability) is an under researched area in the growing body of literature on dynamic capabilities. This study aims to examine the relationship between dynamic capabilities, innovation performance and profitability of small and medium sized enterprises operating in volatile environments. A multi-case study design was adopted as research strategy. The findings reveal a positive relationship between dynamic capabilities and innovation performance in the case enterprises, as we would expect. It was, however, not possible to establish a positive relationship between innovation performance and profitability. Nor was there any positive relationship between dynamic capabilities and profitability.

The main contribution of this study is a better understanding of the realm of small and medium sized enterprises' internal and external business atmosphere. A sphere dominated, on the positive side, by high product quality, high product innovation, high flexibility, a very low return rate of failed products, a flat organization structure and an involving style of leadership. On the opposite pole it was dominated by a lack of systematism, assessment, monitoring, marketing speculations and feasibility calculation. Furthermore, the sphere was dictated by asymmetric supplier-customer relationships and negotiation power leading, among other possible factors, to meager profitability.

Key Words: Dynamic capability, innovation performance, profitability, SME's, case study

Introduction

Researchers as well as practitioners agree that innovation is a precondition for sustainable competitive advantage (Im and Workman, 2004; Teece, 2007; Shang et al., 2009). Companies compete in a globalized world where market conditions are changing rapidly and the need for updated market and technological knowledge is important. Due to this, it is argued that companies need to develop dynamic capabilities which make them able to adjust their technology and their market offerings and thereby create ownership of difficult to replicate resources and competencies (Teece and Pisano, 1994; Teece, 2007). Examining the body of literature reveals that the majority of contributions are theoretical and conceptual, departing from a one-sided paradigmatic research tradition and further, that the generic research motivation is related to firm performance and profitability. Research questions such as, how can competitive advantage within a firm be achieved and can it be sustained over time? (Eisenhardt & Martin, 2000), further, '*Why are firms different?* and *why do firms in the same industry perform differently?*' (Zott, 2003: 97), or '*How can product innovations generate organizational renewal?*' (Danneels, 2002: 1095), capture the essence of initial contemplations that have fueled research in this field.

In the earlier contributions of dynamic capabilities the innovation concept is not given much attention. However, Danneels (2002) has investigated how product innovation contributes to the renewal of the firm through its dynamic capabilities, with point of departure in an inductive qualitative research approach, collecting data through interviews, observations, and documents. The main focus on dynamic capabilities has been on a firm analytical level targeting the performance of enterprises operating in fast changing technological environments, changing customers and high level of competition (Teece et al. 1997; Danneels, 2002; Zahra et al., 2006). Lin et al., (2012), develops a research framework focusing on

the relationship between market orientation, customer knowledge management, and market knowledge and product innovation from a dynamic capabilities perspective. They found that higher degrees of knowledge about customer management and the market lead to better product innovation performance. They applied quantitative research design developing hypotheses that were tested via the structural equation model (Jöreskog & Sörborg, 1996).

Nonetheless, even though some research has focused on innovation the area still needs enlightenment particularly departing from a qualitative research posture. Moreover, the relationship between dynamic capabilities and product innovation performance and profitability has not been addressed yet, let alone, in small and medium enterprises, that have particular characteristics compared to large enterprises. Further, note that the concept of dynamic capabilities is motivated in creating a better theory of firm performance (Teece et al., 1997;) and thus profitability. We aim to address that relationship empirically and explorative in this study applying a qualitative research approach. More specifically, do dynamic capabilities yield high innovation performance and profitability in SME's as we would expect?

Literature review

The notion of dynamic capabilities was first coined by Teece and Pisano in 1994 and elaborated further in 1997 in order to overcome the shortcomings related to understanding how companies create competitive advantage. Teece et al. draw primarily on Wernerfelt (1984) and Hansen & Wernerfelt (1989), resource-based view of the firm and Schumpeter's (1934; 1942) classic work that emphasizes the need for organizational innovation and renewal. The discussion on competitive advantage was in the 1980'ies mainly departing from the strategy literature such as the competitive forces approach developed by Porter (1980) and the strategic conflict approach (Shapiro, 1989). Within the first mentioned approach it was discussed how a company analyzes its position within an industry and decides how it can defend itself from the competitive forces shaping the industry /environment.

The second approach draws on game theory to understand and analyze how strategic moves can be initiated to influence the rivalry among the competitors. Both approaches contribute with an understanding of competitive advantage as something that can be created through effective strategies and focus seemed to be on how companies can "best play the game" to prevent competition from entering. The shortcomings of the strategy conflict or game theory perspective relate to a too simplistic understanding that market success is created as a result of strategic games which have been argued not to be the actual case (Dierickx and Cool, 1989). To overcome this, Teece et al., (1997) argue that the resource-based view brings a more nuanced understanding of how companies can create competitive advantage. Since the resource-based view focuses on the creation of firm specific and difficult to imitate resources the value is created in the upstream activities of the market place.

This focus is argued to deliver better market offerings resulting from the value created in converting key resources into distinct or cheaper products or services. However, focusing on building and exploiting firm specific competences results in a less flexible and adaptable organization. This means that companies often have "sticky" resource bundles which cannot easily be converted into something else. Thus, flexibility decreases and makes it more difficult to adjust to changing market environments. Therefore, the concept of dynamic capabilities recognizing that especially companies operating in changing environments need to be able to develop a dynamic view perspective on the resources and competences in order to create competitive advantage is developed (Teece et. al., 1997; 2007; Iansiti and Clark, 1994). So what are dynamic capabilities more specifically? How can the concept be defined? Teece et al. (1997: 516), define dynamic capabilities as, '*The firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments*'. Nevertheless, there exist numerous definitions of dynamic capabilities. However, consensus in the field appears to agree upon dynamic capabilities, as an internal process with the purpose of modifying the resource of a given organization (Ambrosini & Bowman, 2009).

In order to better dissection the body of literature on dynamic capabilities we develop a classification schema which is one of the methodological contributions of this paper. This novel schema demands some elaboration, which follows. The literature review reveals inter alia that the main part of research in dynamic capabilities departs from a logical-positivistic paradigmatic perspective, in contrast, to, naturalistic explorative paradigmatic stand (Patton, 1990). As noted by Layder (1993), the logical-positivistic approach utilizes quantitative and experimental techniques to deductively test hypotheses that depart from theory. The aim is to create nomothetic knowledge that can be generalized to other contexts that the one being studied. On the opposite pole, Patton (1990) elaborates that the naturalistic explorative

paradigm uses qualitative naturalistic methods to create a holistic and context dependent understanding of humans' actions and thoughts. The aim is to create idiographic knowledge that is specific to the particular context being studied. As can be realized based on the above mentioned elaboration on axioms, different knowledge will result pending on the paradigmatic position that guide a given research design. If the majority of research in dynamic capabilities departs from a positivistic perspective, a study departing from a more inductive approach will in itself be a contribution because it will lead to a more "thick" and context dependent understanding of dynamic capabilities. The research strategy of this study is inductive and qualitative in nature. This will be further elaborated in the methodology section below. Table 1 below offers an enlightenment of the dimensions mentioned and is used to classify literature on dynamic capabilities. Note that the classification system is generic and thus can be applied independently of research purpose (i.e. dynamic capabilities). Further it should be noted that the classification schema operates at the poles of paradigmatic postures for the sake of exemplification. Hence, there subsists many paradigmatic positions and the contours between epistemologies are becoming increasingly more indistinct.

Table 1 Paradigmatic classification schema

Paradigm (basic believe system)
Ontology: <i>The nature of reality, i.e. what is reality?</i> (a) Axioms, (constructivism versus realism) (b) Focus of research (qualitative versus quantitative) (c) Quality standards (subjectivity versus objectivity)
Epistemology: <i>How do researchers (i.e. particular group) comprehend reality?</i> (d) Research design (Evolving emergent versus structured) (e) Goal of investigation (understanding versus prediction)
Methodology: <i>How do we retrieve knowledge?</i> (f) Data (word, pictures, movies versus numbers) (g) Data collecting (interview, observation, documents versus experiment, surveys) (h) Analysis (inductive, expand or construct theory versus deductive, test of theory) (i) Findings (holistic, thick versus precise narrow)
Symbols used to classify literature: ■ Adjacent to a constructivist posture □ Adjacent to a positivist posture ● Adjacent to a neo positivist posture ◆ Not addressed in study / paper

Tables 2 below summarize the dissection of literature on dynamic capabilities. More specifically selected papers are assessed based on the purpose of the particular study and on classification symbols (a) to (i) elaborated in table 1. Finally, the last column captures the essential construct that fuels a given study.

Table 2 Summarization of review

Author/ Year	Purpose	Classification Symbols	Generic research stream
Lin et al., (2012)	<i>'To explore the mediating effects of market orientation, market knowledge and customer knowledge management on product innovation performance..'</i> (p.42)	□ (a,b,c, d,e,f,g,h,i)	Product innovation performance (integration)
Molina et al. (2010)	<i>'To study empirically the influence of managerial perceptions of the</i>	□ (a,b,c, d,e,f,g,h,i)	Perception, learning & DC

	<i>environment of DC generation</i> ' (p. 1355)		
Shang et al. (2009)	<i>"Aims at a deeper understanding of the alignment between DC and knowledge management approach"</i> (P. 323)	■ (a,b,e,f,g) ● (h,i) □ (d) ◆ (c)	Service innovation, DC (Integration)
O'Connor (2008)	<i>'..Is to leverage systems theory and recent advances in DC theory to increase our understanding of how firms can evolve a capability for enabling major innovations'</i> (p. 314)	□ (a,d,e) ● (f,g,h,i) ◆ (b,c)	Innovation performance, DC, effectiveness of DC, system approach
Teece (2007)	<i>'..To specify the nature and microfoundations of the capabilities necessary to sustain superior enterprise performance..'</i>	□ (a,d) ■ (f,g,h,i) ● (e) ◆ (b,c)	Firm performance (Integration)
Im & Workman (2004)	<i>'To examine the mediating role of new products and marketing programs creativity between market orientation and NP success'</i> (p.114).	□ (a,b,c, d,e,f,g,h,i)	Product innovation performance
Makadok (2001)	<i>'To examine the nature of the interaction between resource-picking and capability building in relation to rent-creation activities'</i> (p. 396)	□ (a,b,d,e,f,h) ◆ (c,g,i)	Firm performance / profitability (integration)
Teece et al. (1997)	<i>'To explain firm-level success and failure'</i> (p. 509)	□ (a,d,e) ● (b,f,g,i) ■ (h) ◆ (c)	Firm performance (integration)
Hansen & Wernerfelt (1989)	<i>'To begin such an integrated examination of firm profitability'</i> (p.509)	□ (a,b,c, d,e,f,g,h,i)	Firm performance (integration)
Wernerfelt (1984)	<i>'To develop some simple economic tools for analyzing a firm's resource position..'</i> (p. 171)	□ (a,b,d,e,i) ● (f,h) ◆ (c,g)	Firm profitability (Resource perspective)

Several realisations can be conveyed based on table 2 above. First, that the main part of studies conducted in dynamic capabilities departs from a positivistic posture (Lin et al., 2012; Molina et al., 2010; Luca et al., 2010; Teece, 2007; Im & Workman, 2004) to mention some. Exceptions, albeit, exist, namely Shang et al., 2009 that aims at a 'deeper understanding' which is consistent with the proclaimed domain of this specific studies paradigmatic position. Shang et al., 2009 undertakes a case study to create a deeper

understanding of the configuration between dynamic capabilities and knowledge management approach. They argue that dynamic capabilities could be a precursor for knowledge management and this will sustain service innovation. Second that the earlier 'research' contributions in dynamic capabilities are almost exclusively theoretical and conceptual in nature (Wernerfelt, 1984; Teece et al., 1997; Makadok, 2001) to mention some. That is, that the foundation of knowledge shared by a group of researchers, i.e. a paradigm, is not backed by empirical investigations. An exception, however, is (Hansen & Wernerfelt, 1989). Molina et al., (2010, p. 1355) vents adjacent to the imbalance between theoretical and empirical contributions that, "*The proliferation of theoretical papers has produced a disconnected body of research*". In the more present body of literature, that is, 2005 and onwards an increase in empirical papers, however, befalls for example, (Lin et al., 2012; Molina et al., 2010; Luca et al., 2010; Shang et al., 2009; Zott & Amit, 2008; Zawislak et al., 2013). Nonetheless, the majority of published papers are theoretical and the need for more empirical based knowledge is still unfulfilled. Third, that generic research interested is related to the performance of an enterprise operating in a volatile internal and external environment and to the performance of product and service innovation because a high performance is presumed related to profitability on the firm level. More specifically, the generic study objects can be condensed to four dimensions namely, (1) Firm performance (Lin et al. 2012; Teece, 2007), (2) firm profitability (Makadok, 2001), (3) product & service innovation (Lin et al., 2012; Im & Workman, 2004), (4) and lastly, that an integration perspective is employed (Zott, 2003; Teece et al., 1997).

Paradigmatic stand of the study and methodology

A case study was undertaken, i.e. a qualitative paradigmatic posture. It was designed as a summation design 2 (Grünbaum, 2007). That is, a design with numerous unit of analysis achieved by studying one unit of analysis in multiple cases. More specifically, the unit of analysis was key informants (Gilchrist & Williams, 1999) constituting the top management with the owner and the top management (e.g. the C-level, CEO, CFO, and COO), in small and medium sized manufacturing companies situated in Denmark and Germany, operating in volatile environment. The rationale behind the summation design 2 is to enhance transferability of inferences and to increase robustness of findings (Herriott & Firestone, 1983; Eisenhardt, 1989), drawing on a replication logic (literal/theoretical), (Yin, 1994). The key informants were thus purposeful selected according to Kuzel, 1999; Morse, 1989.

More specifically, we used 4 sampling technique, namely a. 'theory based', b. 'intensity'. C. 'convenience' (Patton, 1990: 169-183) and c. 'learning intense' (Stake, 2000: 446). We developed a rather structured interview guide based on theory related to the purpose of our investigation. First, we were interested in back ground data of the company, i.e. name, home country, contact person (key informant), function of contact person, organizational structure, number of employees, financial key figures, trends, development and level et cetera, second, we probed about 'innovation input indicators' activities, i.e. R&D level, R&D spending, number of employees involved in R&D and engineering, level of education among employees et cetera. Third, we probed about 'innovation output indicators', i.e. number of patents and or copyrights within the last three years. Did the development of new product lead to new business areas? How much of the total revenues were generated based on new or substantially modified products within the last three year et cetera. Fourth, we were interested in process indicators of innovation, that is, strategy and environment, more specifically, issues related to customers, competitors, technology, innovation strategy, concept development.

Furthermore, we asked about resourcing and implementation, that is, resource commitment and funding, knowledge, product/service development, project management, change management. Additionally, we focused on organizational structure and culture, more specifically, formal structure, style of leadership, entrepreneurial climate, transparency and communication, incentives and rewarding. Lastly, we probed about learning, more specifically, advanced education, reflecting and reviewing, codifying and documentation, sharing experience, external learning.

We thus applied two data generation techniques namely, the qualitative interview and written documents method (Marshall & Rossmann, 1989; Yin, 1994) leaving the third known method, observation, out. Specifically, we conducted seventeen interviews in six case companies during a thirteen month period. We have in average spent four hours in each company. Fifteen informants were interview. Of the seventeen interviews six were follow up interviews, that is, clarification, check of inferences et cetera. We analyzed the rather comprehensive empirical data by using a pattern matching logic as emphasized by Yin (1994: 106-109) and Miles & Huberman (1994: 69-72).

More specifically, we are looking for identical patterns across the cases and for patterns that are related to our study purpose. Finally to secure the truth value of our findings, that is, conformability or objectively, i.e. a neutral position of the researcher, we recorded all interviews and made a partial transcription, we made notes during the interviews and immediately after the interviews, we have strived to create a chain of evidence (Yin, 1994: 34) in the analysis of data, we have conducted member check (Guba, 1981: 316), i.e. presented inferences to informants for approval, discussion and possible amendment, and finally we have conducted several follow up interviews based on the member check. We did this to give other researchers the possibility to confirm our data collection, interpretations and presentation of findings. To secure auditability or reliability, that is, to which degree other researchers can replicate the findings of the study, we have developed a case study database (Yin, 1994) comprising documents (i.e. interview notes, paper articles, consultancy rapport etc.) about each company and number material (i.e. innovation budgets, annual account, etc.).

In addition, we have developed an interview guide based on both theory and empiricism (Eisenhardt, 1989) and further applied it in all the companies. To secure the authenticity or trustworthiness of the findings, we have conducted individually company analysis Patton, (1990: 274-275) and secondly we have worked with rival propositions (Webb et al., 1981: 46-48) throughout the study. Lastly, to secure transferability or external validity (Campbell & Stanley, 1983), we have made holistic content dependent descriptions, or as Geertz (1973: 5) coins it, '*Thick descriptions*'. Furthermore, we have crafted a multi-case design and as mentioned conducted separate analysis on each case giving us the possibility to identify idiosyncratic aspects and seeing them in perspective. Table 3 below offers a summation of our methodology and extent of field activity.

Table 3 Methods

Research design	Unit of analysis	Sampling	Data collecting	Data analysis	Truth value
Multi-case design	Top management	Theory based	Interviews	Pattern matching logic	Conformability
		Intensity	Documents		Auditability
		Convenience			Authenticity
		Learning intense			Transferability
Field activity	17 interviews in six case firms	15 key informants probed	App 4 hours in each firm		

Findings

We are as mentioned interested in the relationship between dynamic capabilities, innovation performance and profitability (i.e. net profits). Hence, we have investigated profitability in the case companies and innovation performance as a consequence of the extent of dynamic capabilities. We identified high innovation performance in several of the case companies.

Positive patterns in high innovation performance case companies

A string of positive traits subsisted in all the case firms. Thus, informants voiced that they considered their innovation performance as above average compared to their competitors. They build the assessment more on soft facts than on hard facts obtained during systematic measurements. The soft facts constituted feelings based on many years of experience and small talk conversations with customers and competitors for example during informal meeting on trade fairs.

Other identical characteristics were a low return rate on product failure and thus high product quality. They, moreover, had a close relationship with their customers characterized by trust, openness and willingness to share information and to cooperate. Furthermore, the customer relationships had a time span from 5 to 12 years. As one informant noted related to information sharing and openness,

“Calculations, that is, it is, we have always done that.... they know our costs and well thereby also our profit margin”.

Additionally, they systematically used forecast methods, i.e. role play and expert assessments on the qualitative side and data mining and extrapolation based models on the quantitative side, to predict future customer needs. The assessment of employees' knowledge, education level, cooperation and communication skills etc., was very positive. This was also reflected in level of education of the employees. They typically hold a master degree in science and engineering. A high level of employee satisfaction was recorded primarily as a consequence of a high degree of influence on the planning and executing of ones working obligations. Likewise, customer feedback was systematically stored and used in relation with modifications and product development. Innovation processes were often customer driven. As one informant puts it,

“It is more the rule that the exception, that our customers simply, has a very clear picture of what they want from us, actually very detailed, often I wonder why they do not it themselves..”

Further, they had a high knowledge of their close competitors and the dynamics of the market. This high knowledge level, albeit, was not applied to facilitate a cooperating with the competitors, on the contrary, they had no cooperation with competitors (i.e. arm's length relationship). Moving on to production technology, they possessed a very specific and high knowledge of the firm's core technology which they further believed to be sustainable. As one informant said,

“Well production technology that is my baby, I mean, we all love machines and the physical creation process. You must remember that was the main reason for most of us to go to uni (university). Not because of the boring books / lectures... no offence... but because we could split machines and see how it really worked”

Moreover, they systematically used tool-based methods to assess the development of existing and emerging technologies (i.e. patent analysis and technological life-cycles models etc.). Regarding innovation strategy, there was a strong feeling of coherence between the future developments of the company through innovation.

Gloomy patterns in high innovation performance case firms

In contrast, they only to a lesser degree define innovation goals, i.e. time, cost, quality, beforehand of the innovation process. More startling, they did not check systematically the financial or technical risk or profitability of innovations projects. Courses of actions, systematics etc. was typically stored in the minds (i.e. tacit knowledge) of few key employees making the case firms more dependent on employee retention. This was a firm pattern displayed in all case companies. In the same vein, they did not systematically search for new ideas, nor did they use methods (for example, creativity methods) for developing new ideas. Furthermore, they did not use clear criteria for assessing and prioritizing new ideas. As one informant noted,

“No, not really, you see we know the customers and they know us, they simple request what they wants. There is no time at all to create new stuff.. we are much too busy..”

Concerning funding, they had no access or cooperation with governmental institutions nor did they have a systematical cooperation with universities to help develop their knowledge base. They did not, intra organizationally see possibilities to fund unexpected or sudden arising product development opportunities, as good. One informant noted,

“Well it is uphill, rather strange I find it, it is not the first time we undertake a development project, you know, actually we do it all the time, nevertheless getting money, funding is hard..”

Likewise, they found the funding structure for product development, inflexible. That is, employer resources and other resources related to the daily operation of the firms were indeed present. More ad hoc needs such as a purchases, like specialized consulting knowledge, related to a given development project did, however, not have a separated funding reserve. Nor were any clear guidelines offered related to purchasing, for example lists of typical purchases and persons in charge related to a certain type of development projects. Thus, there were no clear organization structure and each buy and buying decision had to advance through the “normal” organization structure, leading to a protracted, inflexible and bureaucratic process. Summing up, a formal system handling the management of development projects did not exist in the case companies. Further, they were not familiar with methods to identify strategies of competitors. Nor the one we probed fore (i.e. scenarios, portfolio, five forces etc.) or others that they were able to mention. More specifically, they did not scan the competitive environment or conduct ongoing and systematic analysis of the competitors. Likewise, they did not analysis the competitors' products,

technology, reputation, distribution channels and relative market share in order to access the impact of the competitors offering on the case companies own portfolio of services and products.

Regarding product development, the findings were somewhat ambiguous, that is, the inter department (i.e. marketing, design, engineering etc.) cooperation was high in most case companies with some exceptions on the opposite pole. Moving on to project and change management, some clear patterns emerged. Unfortunately, the innovation projects were almost never completed on time. Nor were the different roles of members clear and well communicated. Moreover, progress of innovation projects was not assessed and monitored. The decision making process, in contrast, within the innovation project, was short and flexible. Note from the above-mentioned descriptions of findings that both expected and unexpected patterns across the case companies prevail. That is, we find unexpected patterns that are inconsistent with theoretical predictions. The generic characteristics are summated in table 4 below divided in positive and negative individualities.

Table 4 Positive versus gloomy traits

<i>Positive traits</i>	<i>Gloomy traits</i>
<ul style="list-style-type: none"> ➤ Innovation performance above average ➤ Low rate on product failure ➤ Close customer relationship ➤ Systematically use of forecast methods to predict customer needs ➤ Systematically storage of customer feedback used to product development ➤ Customer driven innovation ➤ Systematically use of tool-based methods to assess technology ➤ A high coherence between future firm development trough innovation ➤ High knowledge level of firms core technology ➤ Short and efficient decision making process 	<ul style="list-style-type: none"> ➤ Lack of systematism / tacit knowledge ➤ Lack of assessment ➤ Lack of monitoring ➤ Lack of feasibility calculations ➤ Lack of liquidity calculations ➤ Lack of profitability calculations ➤ Lack of budget planning <p>Lack of marketing speculations, this combined with, asymmetric supplier-buyer relationship and imbalance in negotiation power, is a dangerous cocktail</p>

What about profitability? It was surprisingly not possible to establish a positive relationship between innovation performance and profitability or between dynamic capabilities and profitability in the case firms. More specifically, the case firms experienced in the last three year a decrease in gross profit in the interval 15 percent to 60 percent, a decrease in profit before net financials (i.e. EBIT) in the interval of 78 percent to 133 percent, a decrease in net profits in the interval of 81 percent to 140 percent. The ratios for the latest annual report (i.e. 2011) illustrated a return on assets in the interval 3 percent to minus 9,8 percent and a return of equity in the interval 1,3 percent to minus 65,4 percent, that is, in sum, a rather disturbing development. Table 5 below summates the figures related to profits.

Table 5 Profitability figures

<i>Results & Ratios</i>	<i>Development last 3 years percent</i>
Gross profit	Minus 15 % to 60 %
Profit before Interest & Tax (EBIT)	Minus 78 % to 133 %
Net profits	Minus 81 % to 140 %
Return of assets (ROA)	Plus 3 % to minus 9,8 %
Return of equity(ROE)	Minus 1,3 % to 65,4 %

It could be argued that the worldwide financial crisis that started with the crack of Lehman Brothers Holding Inc. on September 15, 2008 could be the main reason for the deteriorating of the activity level in general and this thus indirectly has caused the financial development in the case companies. However, the very core of the DC concept is the ability to react swiftly and efficiently to changes in the business environment and since the financial crisis has lasted for some years now we had expected to find a positive relationship between DC and profitability.

Discussion

How can the profitability paradox be explained? Why is that the case? A picture emerges that could offer preliminary explanation, namely, despite high flexibility, high product quality and high degree of renewal of products there was distinct lack of systematism, assessment, monitoring, feasibility calculation, liquidity and profitability calculations and budget planning. A more intuitive process prevails which is not based on key figures and numbers.

The more formal foundation of decision making thus lacks input of key account numbers, calculation of contribution margins and budget planning etc. Likewise, integration of marketing speculation was meager. In essence, they are unable to answer questions like, what is the market for this new product, what are the development cost of this innovation project, what need do we fulfill with this product, what are the export potential for this product, what are the cost and benefits of a given innovation project.

In a nutshell, contributions from marketing and accounting is surprisingly underrepresented in the strategic decision making process related to innovation strategy, concept development, commitment and funding of resources, product development, project and change management. This, we speculate, can be attributed to the size of the companies. Take, for example, the initial decision of starting an innovation project and the control and evaluation of the process. It was often made by one individual, i.e. owner or CEO, based on tacit knowledge. For example former experience, or this is an important customer, thus we have to 'solve' this particular problem for them. Often (or always) the supplier-buyer relationship was asymmetric were the case firms constitutes the much smaller part (i.e. the supplier). Hence, an imbalance in negotiation power was distinct. Renewal of products thus had many elements of particularity related to few or one customer making it difficult to profit from the novelty of the product in other business areas. Furthermore, the concentration of tacit knowledge and low degree of more formal documentation of procedures made the case companies particular vulnerable if key employees left the organization. Put in a more colorful manner, the competencies were butter thin in some areas more rife than in others (i.e. marketing and internal accounting).

Practical implications

The importance of an updated and well-structured information decision system should not be underestimated. It was a clear lack in the case firms of this investigation. Based on the findings and subsequent discussion, we speculate, that the incomplete information systems in the small and medium sized case firms is the main contribution factor to the unfortunate development in profitability and key figures. Consequently the management in the case firms and in firms with identical characteristics would benefit from posing the following generic strategic questions in table 6 below,

Table 6 Generic Strategic Questions

<i>GS questions</i>	<i>Theoretical concepts</i>
<ul style="list-style-type: none"> ➤ Is there a market for the new product/service? ➤ What is the size of the market? ➤ What is the export potential of the market? ➤ Which need do we cover with the new product/service? ➤ What is the expected life time of the new product/service? ➤ Can we reuse modules of an innovation project in future project? ➤ What is the ideal buyer-seller relationship in this market? ➤ What are the relationship drivers in this market? 	The marketing function, i.e. business to business, international marketing, relationship marketing
<ul style="list-style-type: none"> ➤ What are the development cost of a given innovation project? ➤ What are the cost & benefit of a given innovation project? ➤ What is the contribution margin of the product/service? ➤ Can we measure all the cost associated with the development? ➤ Can we identified all cost related to an innovation project? ➤ Can we divide all the cost in variable and fixed costs? ➤ What is the "correct" price of the product/service? ➤ Do we internally have an influence on price setting? 	The accounting function, i.e. internal accounting
<ul style="list-style-type: none"> ➤ Are there any competitors on the "new" market? ➤ What are the strength and weakness of the competitors? ➤ What are the entry and exit barriers to the market? ➤ What is the degree of competitive level in this market? ➤ Do we the correct capabilities to craft a superior strategy? 	Strategy

Conclusion and future research

In this case study it was possible to demonstrate a positive relationship between dynamic capabilities and innovation performance in small and medium sized technical enterprises operation in volatile environment. However and rather surprisingly, we could not establish any positive relationship between innovation performance and profitability between dynamic capabilities and profitability even though many elements of DC were present. We speculate that this can be attributed to the size of the participating case firms in this study. More specifically, that imbalanced supplier-customer relationship prevailed, creating a skew negotiation power combined with a concentration of decision making with very few individuals in the case firms in combination with extensive use of tacit knowledge and a low degree of systematism, assessment, feasibility calculations and lastly, few marketing oriented speculations.

Directions for future research could be more empirically based investigations from a different paradigmatic posture on the relationship between dynamic capabilities and profitability. Furthermore, the role of marketing and internal accounting in firms heavily influenced by an ‘engineering and technology’ culture additionally needs more clarification. Moreover, it would be interesting to clarify the relationship between profitability of SME’s with a low degree of DC and low innovation performance as we would expect those firms to have a more problematic development in the key financial figures.

Finally, since we speculate that firm size plays an important role it would be interesting to investigate a large company regarding the DC and profitability relationship. That is, we believe that large companies will possess a more complete portfolio of competence and thus have a better knowledge foundation to make the right strategic decisions instead of merely reacting based on intuitions. A SME hence needs to pay close attention to its portfolio of competences. If it is incomplete leading to a “broken” value chain they need to deal with this matter. That is, training and hiring the right employees’. The results of this study suggest that especially competences in marketing and accounting could be an area that needs to be reinforced in small and medium sized technical manufacturing enterprises.

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ANTI-CRISIS MEASURES OF ECONOMIC POLICY IN LITHUANIA AND IN OTHER BALTIC COUNTRIES

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Abstract:

The article deals with the economic situation and the state economic policy in Lithuania before and during the crisis. The pre-crisis period, i.e. 2004-2007 years, were the years of the fast economic growth in Lithuanian and other Baltic countries economies, which were unprecedented in postwar Europe. The growth Lithuanian economy was interrupted by global economics and finance crises, which appeared in Lithuania in 2008 year. The macroeconomic situation of Lithuania, the main factors influenced to economy situation of country and means of government economy policy before and in the period of crisis using statistic date are discussed. The anti-crisis policy of other Baltic countries is presented in the article. The statistic data showed that economic processes were similar without essential differences in all Baltic countries with exception the spheres of public finances where Estonia had obvious advantage in comparison with Lithuania and Latvia.

Key Words: Anti-crisis measures, economic policy, global finance crisis, macroeconomic processes

Introduction

The Lithuanian economics situation and state economics policy in the period after joined Lithuania the European Union, i.e. after 2004 year are analyzed in the article. The period under consideration includes pre-crisis and crisis periods. The pre-crisis period, i.e. 2004-2007 years, were the years of the fast economic growth in Lithuanian economy. Decreasing unemployment, increasing income, hard currency and financial support of EU were the main factors of the growth of Lithuanian economy. The growth Lithuanian economy was interrupted by global economics and finance crises. The current financial crisis that struck the world has affected the majority of world countries on a larger or smaller degree. Due to the economic crisis, the growth of economics in the EU countries considerably slowed down and the number of unemployed increased a great deal. The Baltic countries suffered perhaps most of all their economic depression was very painful. The onset of the current financial crisis is considered to be 2007, when the Federal Reserve System of the USA had to interfere and grant liquidity to the bank system (Soros, 2009). Famous American economist – J. Stiglitz (2006), (Felton, Carman, 2008) paid attention to a deteriorating economic situation of the country and wrote about a possible financial crisis in the USA before its onset.

The current global crisis is not the only worldwide crisis in the new history of humanity. We are aware of such economic crises that have affected more than one state and therefore they can be called as worldwide crises (Dash, 2001; Feldstein, 1991; Sylla, 2009; Davulis, 2012). The current global crisis stands out from the previous ones by its measures. It affected the majority of world countries. In this respect it surpassed even the Great depression of 1929-1933 (Eichengreen, O. Rourke, 2010). It should be stressed, that the severe lessons of the Great Depression were not in vain and the governmental response to economic recession was much more expeditions than in 1929 (Romer, 2009). For example, in 2008, the European Commission (Commission of the European Communities, 2009) prepared a restoration plan of economics which implies the increase of demand by enlarging the purchasing capacity of population and restoring the confidence of investors.

Regarding the causes of the current crisis we can enumerate a lot of them. We shall restrict ourselves only to two aspects that, in our opinion, are essential, namely, disorder in stock exchange caused by collapse of real estate bubble and globalization of the world economics. The two aspects distinguish the current global crisis from other crises. Modern financial markets characterizes by application of very complicated derivative financial measures. Though theses derivative measures were created namely to diversity and diminish the risk, because latest years showed that banks and

investment companies assessed the risk insufficiently. It was one of causes of the current world crisis of finance and economy and the processes in the real estate market were the detonator that invoked the global crisis.

Another important peculiarity of the current global crises is the influence of globalization processes on the spread of economic problems in whole world. Globalization has both positive and negative consequences. The intensifying integration of financial markets is related with the growing risk and uncertainty. Therefore it is difficult to predict its consequences. On the other hand, with an increase of interrelations and dependences between global financial markets and economics, the risk of problem transmission increases as well.

In the article, the factors that influenced the fast growth of Lithuanian economy in the pre-crisis period, the main causes of the global financial crises as well as its effect on the Lithuanian economics and measures of economic policy of governments in the period under consideration are discussed. Based on statistical data, the macroeconomic state in Lithuania and other Baltic states is analyzed in the period after 2004 year. Such investigation has a sense for the sole purpose of avoiding the economic policy errors made in the future.

The macroeconomic situation in Lithuania before the crisis

2004-2007 were the years of the fast economic growth in Lithuania which, according to Rosenberg, (2008) were unprecedented in postwar Europe. In this period, the country's GDP was constantly growing and in 2007 its growth rate reached up to 9.8 percents (Fig. 1).

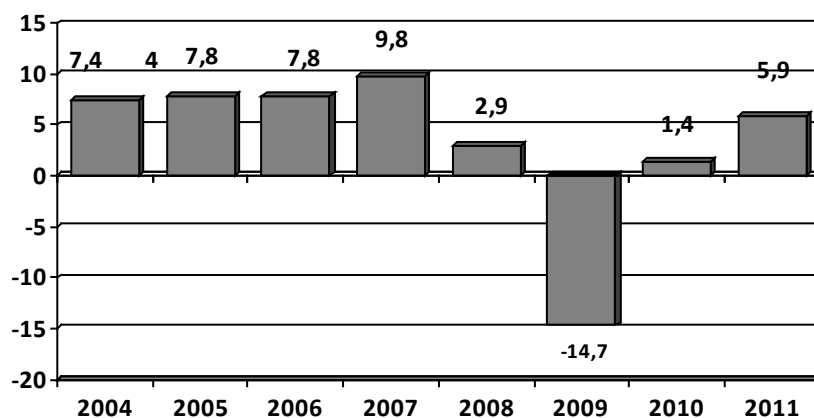


Figure 1. The yearly alteration of Lithuanian real GDP in 2004-2011 (in percent). Source: Lithuanian Department of Statistics

With the growth of economics from 2004 to 2007, unemployment also decreased constantly, the level of which diminished from 11.4 percents in 2004 to 4.3 percents in 2007 (Fig. 2).

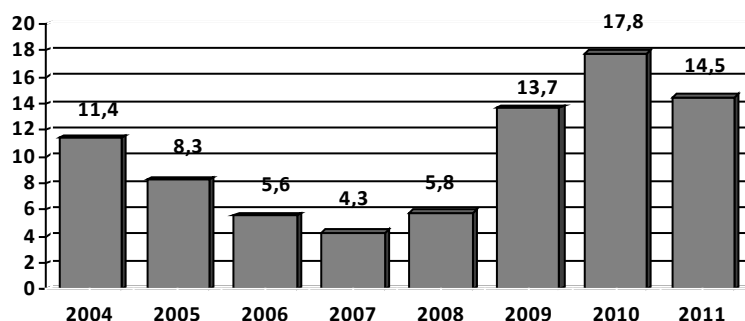


Figure 2. The level of unemployment in Lithuania 2004-2011 (in percent of GDP). Source: Lithuanian Department of Statistics

The improving economic situation in the country, increasing employment and wages, favourable prospects of the country's future slowed down emigration streams a little bit in 2004 – 2006 (Fig. 3).

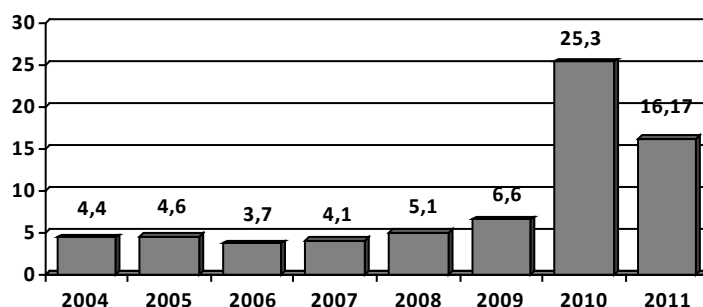


Figure 3. The dynamic of emigration from Lithuania in 2004-2011 (in thousands of peoples). Source: Lithuanian Department of Statistics

The growing country's economics, favourable conjuncture of the international market with the rising needs for importable production of other EU countries allowed us to uniformly increase the country's exported production volumes - in 2008, the country's export amounted up to 25.5 percent of its GDP level.

Thus, to onset of the crisis Lithuanian economic increases. Decreasing unemployment, increasing income, hard currency and financial support of EU were the main factors of the growth. These factors laid the basis, as it is evident at present, to cherish grounded hopes as to the future of the country. Guided by these hopes, both enterprises and households began borrowing for consumption and business ever more and all the more that the banks granted loans with engaging interests. The largest share of loans received by a household was aimed at the real estate market. This process was stimulated by state given tax privileges for lodgings loans which established conditions of forming a real estate bubble. According to the data of the Bank of Lithuania, the volume of loans to acquire lodgings has grown from 50 million Lt in 2004 up to 720 million Lt in 2007. Such an expansion of credit had a decisive influence to form a 'bubble' in the Lithuanian real estate market.

Thus from 2004 up to onset of the crisis Lithuanian economics was growing due to the growth of domestic demand, maintained by ungrounded future expectations. The growth of domestic demand stimulated increase of import as well. However the increase of import was not counterbalanced by an adequate export increase, i.e. export volumes lagged behind from that of import until 2009 and thus the country's foreign trade balance was negative (Fig. 4). A constant foreign trade deficit also determined the growth of the current account deficit. In line with the data of the Bank of Lithuania, the current account deficit in Lithuania has grown from 2004 to 2007 almost 300% and exceeded 14 milliard Lt.

The global financial crisis the first signs of which appeared in the USA in 2007 before long reached Lithuania, too. As shown the statistical data (Fig. 1), the rate of the country's GDP growth that reached almost 10 percent in 2007, fell down up to 3 percent in 2008 and even 15 percent in 2009, thus pushing Lithuania among the states that suffered most from the crisis. Due to this reason the budget deficit in 2008 amounted up to 3,2 % and in 2009 nearly 9% of the country GDP, i.e. it exceeded the size set by the Maastricht agreement almost three times. Only in the years of recovery country's economy state budget deficit began to decrease and at the end of 2011 it reached 3.3 percent of GDP, i.e. it exceeded Maastricht criterion slightly. With a downturn of production unemployment began to grow in the country which amounted up even to 13.7 percent in 2009 (Fig. 2), which became a serious problem of country's economics. Emigration from the country started increasing again too and reached more than 25 thousands of emigrants in 2010 according to official data of the Lithuanian Department of Statistics (Fig 3). Lithuania was not ready for such a situation, - its strategy for economic development was based on the macroeconomic stability and on assumption of a uniform growth of economics (Rakauskiene, Krinickiene, 2009).

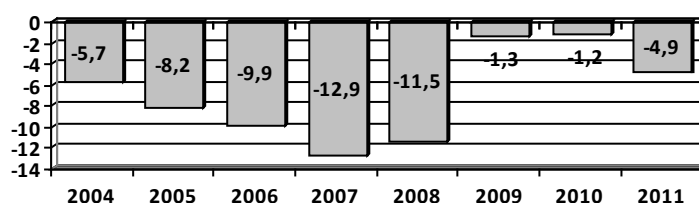


Figure 4. The foreign trade balance of Lithuania in 2004-2011 (in percent of GDP).

Source: Lithuanian Department of Statistics

A constant foreign trade deficit also determined the growth of the current account deficit. In line with the data of the Bank of Lithuania, the current account deficit in Lithuania has grown from 2004 to 2007 almost 300% and exceeded 14 milliard Lt.

After the burst of the “bubble” in the real estate market of Lithuania, the credit interest, given by the banks acting in Lithuania, have grown as well. That affected negatively the subjects of Lithuanian economy and not so small part of enterprises went bankrupt. Only the processes in the county’s real estate market could invoke economic depression, however, mostly the outside factors have affected our economics. Because the balance foreign trade (Fig. 4) and the current account of country, was in deficit, thus in such a situation, the economic growth was feasible only by borrowing in the international finance market to cover the deficit. However, due to the global crisis, increased interests stopped the flow of foreign credits and shook the economic growth basis of the country. On the other hand, the global crisis predetermined slowdown of economic growth and consumption decrease of many world countries. Decreasing consumption of foreign countries restricted the chances of Lithuanian export and that was one of the most important factors which determined the country’s economic depression. The domestic market of Lithuania is too small to maintain the growth of economics and to compensate the decrease in export. With the revival of markets of foreign countries, Lithuanian possibilities have made better as well. The 2010 years became years of beginning the recovery of Lithuanian economy – all main macroeconomic indicators slowly but constantly began to increase. The 2010 years became years of beginning the recovery of Lithuanian economy – all main macroeconomic indicators slowly but constantly began to increase.

Though the signs of global crisis were evident rather early, Lithuania met the crisis quite rivearly. Such a situation was predetermined by insufficient competence of our government, lack of responsibility, and maybe political reasons. As a result, Lithuania met the crisis with the chrome foreign trade and current account deficit, with debts of the state and private sector and without any reserves accumulated.

Opponents often reproached the former government that it ungroundedly raised salaries of state office employees as well as pensions of pensioners and did not accumulate any financial reserves for the solving most necessary problems arising during the crisis. In our opinion, opponents are right part. On the other hand the greatest errors of the government are not here. It was indispensable to increase salaries with the view of avoiding the loss of the last good specialists. This measure proved to be true: emigration was slackened and even decreased (Fig. 3). If we create the state welfare, pensioners also have the right to a certain level of wellbeing. Thus the decisions to increase salaries and pensions were necessary and they improved the state welfare indeed. On the other hand, when making these decisions the government did not provide for their constant financing taking into consideration a possible economic down turn.

Much more serious errors of this government were associated with public finances. Despite rather high rates of GDP growth in the country, year after year expenditure of the government sector in 2004-2008 exceeded its revenues, i.e there was a deficit state budget (Fig. 5).

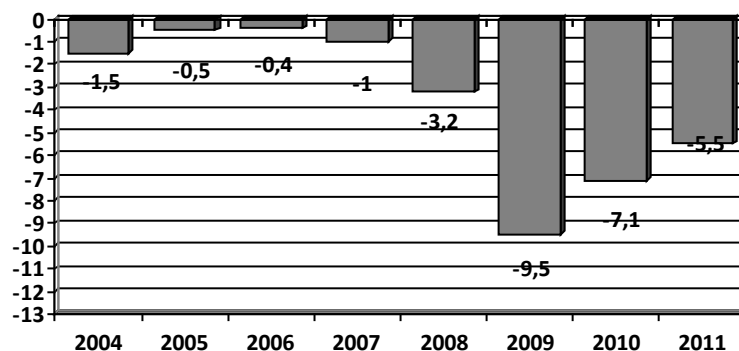


Figure 5. The Lithuanian state budget balance in 2004-2011 (in percent of GDP).

Source: Lithuanian Department of Statistics

Though the budget deficit before crisis was not so high, under the conditions of fast economic growth, it increases the economy overheat. On the other hand, the constant budget deficit increased the country's debt which is unacceptable under the conditions of the economic growth. Meanwhile budget surplus would not allow economy overheating and would establish conditions for accumulating the necessary reserves and financing the augmented state liabilities under the cyclic conditions of recession.

Another obvious error of the government is tax decreasing in the period of too rapid economy upturn, which is also contradicting economic principles. The tax policy of that period had to be contrary - an opportunity was missed to impose a real estate tax (of course, with an exempt minimum), luxury wealth tax as well as a progressive tax system. All these measures could also accumulate the necessary finance sources to cover state expenses. Thus, the formation of deficit budget and tax diminishing in the years of a rapid economy upturn were the largest government errors that caused sore consequences in the crisis period.

The right step of this government was adoption of the fiscal discipline law in 2007, aimed at ensurance of financial stability and a stable development of economy. The law has set that the deficitive governmental sector in 2008 can not be larger than 0,5 % of GDP. Unfortunately, this law was passed too late and its requirements could not be realized with the onset of the crisis.

The Bank of Lithuania has also not estimated enough the scale of the pending crisis (Sharinas, 2008). It stated that the direct impact of the global crisis on the finance system of country can not be considerable because it are not closely connected by economic and financial links with of the investment banks and other institutions of the USA. On the other hand after the Russian finance crisis in 1998, supervision of commercial banks of the country was intensified, which ensured the stability of the Lithuanian finance system. However the near future has shown that the Bank of Lithuania was not quite right- the supervision of commercial banks was evidently insufficient (Jakeliunas, 2010).

Anti-crisis measures of Lithuanian institutions

In the presence of crisis in 2008 the Bank of Lithuania and Parliament of Republic of Lithuania have made decisions: to diminish the mandatory reserve norm from 6 to 4 percent and to increase the deposit insurance sum up to 100.000 Euro with a view to vivify the domestic market using additional financial resources. Though these decisions were correct and adopted in time, unfortunately, their effect seemed to be insufficient. To maintain the market activity a more intensive promotion of economics was necessary. However, due to an inadvertent and irresponsible budget policy persuaded in the years of economic rise progress, there were no resources to stimulate the economics. Therefore there remained nothing else to do but to take measures that are usually applied not in the period of depression, but in up growth of economics. The newly elected Parliament of the Republic of Lithuania and Government undertook to apply the measure of a restrictive fiscal policy: to decrease expenditure and increase taxes in order to stabilize state finances, which was persistently recommended by the European Commission.

At the end of 2008, decision were made to increase the rate of value-added taxes up to 19% (later on it was increased up to 21%), income-tax, excise duty on fuel, cigarettes and alcohol, as well as to eliminate the majority of reduced tariffs of the value-added tax. The so-called 'night' tax reform has come into force effect since January 1, 2009. This tax reform was aimed not so much with at neutralization of the crisis consequences to economics as at collection of more income to the budget with an expectation to stabilize the state finance system. However according to the statistical data in 2009 much less income was collected to the state budget than in 2008. Certainly, such a result was mostly predestined by the economic downturn, however, there is little doubt that the night reform was not deliberate enough. Even the country's government acknowledged that this reform was wrong in some aspects. Maybe there was some sense to increase the added-value tax tariff in the forever situation, however abolition of all privileges of this tax was a mistake: the budget lost not so small part of income that has left for the neighbouring countries. On principle the increase of the profit tax tariff was right, but it had to be differentiated according to economic branches and the volume of a company, which indeed has been done later on. The opponents' proposition that increase of the profit tax limits foreign investments is not so concurring. The research has shown (Davulis, 2003) that tax privileges have, but a little influence on the volume of foreign investments in the country's economics. Attractiveness of objects to be invested in is much more important for investors. Consequences of excise increasing are also not single-valued to economics.

Thus, the government had to decide on an undersubscribed decision – to pursue the so-called retrenchment policy, i.e., to diminish government expenses by lowering the employers and officeholders salaries, pensions, and social pays such a policy is assessed ambiguously. On the one hand, it allows diminishing government expenses, on the other hand, it decreases income of the population and thereby consumers demand. The decrease in demand weakens the home market even more. The domestic market will revive only if income of the population starts growing and consumers demand increasing. Straight forward decreasing of expenses for all spheres can yield only a short-term effect. Decreasing expenses for the spheres of activities that predetermine the science and technology progress or development of infrastructure can cause long-term negative consequences for the country. Thus, the retrenchment policy would be deliberate enough and balanced.

Though the macroeconomic situation in Lithuania started improving from 2010 years but in our opinion its improving not so which due to the actions of the government, as due to the improved situation in international markets and especially due to recovery in foreign countries that imported goods of Lithuanian producers.

Anti-crisis measures and macroeconomic situation in other Baltic countries

At the end of 2008 Latvian Saima approved the program of stabilization and revival of Latvian economics. The program obliged the government to pursue a strict fiscal policy decreasing the state budget deficit, to establish the stabilization reserve into which money could be transmitted in case of the budget is balanced and the growth of GDP exceeds 2%. The structural reforms were provided in the plan in order to decrease the expenses of the public management by 15%, while financing of social protection measures would not be decreased. Bank of Latvia was obliged to keep fixed ratio between Lats and Euro. In line with the program the government of Latvia plans to decrease the tariff of income tax of inhabitant from 2009 by 2%, to increase the rate of the value-added tax by 3%, to eliminate the majority of reduced tariffs of the value-added tax, to increase the excise duty of fuel, coffee and alcohol as well as to tax dwelling apartment of habitants from 2010. In 2010 the Latvian government submitted a new plan of economics revival to Saima. The stimulation of export, the manufacture of home commodities for replacing import, orientation production to manufacture commodities with high added values as well as stimulation of the economics sectors grounded on the knowledge and innovations have been provided in the plan.

In 2008 the International Monetary Fund, World Bank and finance institutions of EU granted a credit in amounting to 7.5 billion euro (1.7 billion euro from which was granted by IMF) to Latvia to make reforms. Despite that creditors fixed a low interest for credit, but they required to fulfill strict conditions, i.e. to decrease the budget deficit of state up to 3% of GDP in three years, not to increase pensions, to decrease salaries, to set new taxes, to diminish the government management expenses not by 15 but 30%.

Thus, anti-crisis measures are similar both in Latvia and Lithuania. The revival of economics is grounded on the strict fiscal policy and saving in both countries.

Estonia began to execute a strict fiscal policy earlier than the other Baltic countries i.e. before the crisis began. In the years of the fast economic growth this country began to form a surplus state budget and to accumulate fiscal reserves. The accumulated reserves allowed Estonia to avoid the necessity to borrow in the international finance markets paying high interest during global crisis. Despite that Estonia did not have a formal anti-crisis plan, because it hoped to overcome the economic difficulties in the natural manner, Estonia was forced to apply the saving mode, too. Estonian government has also made decisions to decrease the state expenditure, especially, in the sphere of health protection and education, pensions and salaries (by 15%), to increase the rate of value-added tax from 18 to 20%, the excise duty on tobacco products and alcohol and to introduce new taxes. Therefore the accumulated finance reserves permitted to gain obviously advantages for Estonia in comparison with other Baltic countries.

The tendencies of macroeconomic processes were similar in all Baltic countries. As was mentioned above for a number of years the Baltic countries were marked by a considerably faster economic growth than other EU states. According to data of the Eurostat database the maximal rate of GDP growth before crisis amounted almost 10% in Lithuania, almost 8% in Estonia and exceeded 12% in Latvia. However, as the global trade shrank as a result of world economic crisis, the export-oriented economies of the Baltic countries plummeted to an all-time low: in 2009 real GDP of these countries decreased by 14-18 % (14% in Estonia, 15% in Lithuania and 18% in Latvia) as compared to 2008 data. From 2010 the Baltic countries have already shown some signs of recovery in their economies.

Like many other EU countries, the Latvia and Lithuania were facing the budget deficit problem: proportion of fiscal deficits to GDP largely exceeds the limit of 3 % prescribed by the Treaty of Maastricht (9.2 % in Lithuania and 10.2 % in Latvia, but in 2010 their fiscal deficits decreased up to 7-8 % of GDP). In 2010 the proportion of government debt to GDP was equal to 44.7% in Latvia and 38% in Lithuania (in 2011 government debt slightly decreased until 42.6% for Latvia Lithuania and increased until 38.5% for Lithuania). Though these figures satisfy the Maastricht criterion, i.e. not exceeded 60% of GDP, but they were increasing very fast from 2009.

The situation in these spheres in Estonia is much better. Estonia has not any problems with budget deficit due to accumulated reserves. However, one must admit here that Estonia did manage to maintain its financial discipline at the level likely to be envied by other countries with much more economic power. In 2009 Estonian budget deficit stayed as low as 2 % of GDP. The Estonian budget was in surplus amounted to 0.2 % of GDP in 2010 and 1.0 % of GDP in 2011. It still did not exceed the limit of 3 % of GDP, in this way satisfying the Maastricht criterion. Moreover, according to data of the Eurostat database Estonian foreign debt, though it constantly increased during the crisis, constituted only 7.2 % of GDP in 2009, which is substantially less than is required for a country to be accepted to the euro zone. Therefore, Estonia is single state from all of EU states satisfying the Maastricht criteria. It allowed the country to join the European Monetary Union from 1 January of 2011. The most important factors which subsequently led to such remarkable achievements were a well thought-out economic policy, concentration of all national political powers upon one common aim and, as already mentioned, strict financial discipline. The support, which Estonia receives from the Nordic countries, cannot be underestimated either.

All the three countries – Lithuania, Latvia and Estonia – are coping with the problem of emigration. If emigration processes are not suppressed in these countries, they will face serious economic problems in the future. Moreover, in spite of intensive emigration unemployment has become a serious and large scale problem in the Baltic countries. According to data of the Eurostat database, unemployment rate in these countries has reached unprecedented heights during the crisis and amounts to 14-18 % (in 2010 - 16.9% in Lithuania, 16.9 in Estonia and 18.7% in Latvia. In 2011 unemployment rate in these countries decreased).

Conclusion

The domestic and external reasons have invoked the Lithuania economic crisis. Such a small countries of open economics as Baltic countries had no chance of avoiding the effect of the global crisis on its economics but deliberate economic policy of Government would allow to avoid the consequences of global crises for country's economy. The economic policy of Lithuanian governments did not distinguish itself by foresight before and during the crisis. Formation of the deficit budget and tax decreasing under the conditions of a rapid economic growth contradict the economic logic and had

bed consequences for the country's economy with the onset of the crisis. The limiting fiscal policy of the former government with a view to stabilize state finances under the current conditions is right in essence. However the measures to carry such a policy into effect are not deliberate enough and unbalanced. This kind of policy creates additional economic and social problems that could be avoided by realizing a deliberate and long-sighted economic policy of the country.

Despite the fact that Estonia pursued an expedient fiscal policy before the crisis and accumulated fiscal reserves, the character of macroeconomics processes in the all the Baltic countries was very similar and differed insignificantly. True, the accumulated financial reserves permitted Estonia to avoid additional difficulties in the sphere of public finances that the Lithuanian and Latvian economics confronted.

Politicians, economists and financial specialists should deeply study the lessons of the current crisis in order that the errors made could be avoided in future.

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SIDE EFFECTS OF THE 2009 NOMINAL EXCHANGE RATE VOLATILITY IN MEXICAN REMITTANCES' PURCHASING POWER

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Abstract:

The Great Recession emerged as an usual world macroeconomic imbalance, determined by an exchange rate volatility and severe setbacks in international trade, foreign direct investment and flow of labor force. As Western countries tackle their high fiscal deficit and public debt problems, they face historical levels of unemployment. That has made them constrain international immigration, both legal and illegal. Mexico has experienced in this context a fall in remittances as well as in the number of workers leaving for the USA. On the other hand, exchange rate volatility has affected purchasing power of the remittances' recipient families, making them supposedly better off when the MXN depreciates. In order to estimate the net changes in purchasing power, incomes coming from remittances have to be matched with domestic prices, especially of those items which households consume the most.

Key Words: Nominal exchange rate, side effects, Mexican remittances

Introduction

Migration has been an important topic since the 90's due to the increasing number of people moving around the world trying to escape poverty, climate change or political restrictions. In hindsight, present migration is still below the dimensions reached at the beginning of the XX century. Abramitzky (et al, April, 2012: 1) for instance, writes that the US absorbed 30 million immigrants between 1850 and 1913, and that by 1910, 22 percent of the US labor force was foreign born, compared with 17 percent today. Based on the results of several studies, the liberal British magazine *The Economist* (January 5th 2008: 16) concluded that, "if labour flowed without restraint, social and political systems would be disrupted on a huge scale, but global poverty would be vastly relieved". The same magazine emphasized, "because immigrants see the world through more than one cultural lens, they often spot opportunities invisible to their monocultural neighbours" (*The Economist*, November 19th 2011). Bo and S. Jacks (2012: 28) find also that migration has a powerful effect in economic growth and foreign trade. Furthermore, Alan Greenspan (2008) stated that migration also has a high potential to neutralize the economic setbacks derived from the aging population in the industrialized countries. However, the world economic crisis of 2007-2010, has unleashed a wave of protectionist policies that have restrained not only foreign direct investment (e.g. through expropriations and exclusion of strategic sectors), but the free flow of merchandise and services, as well as the labor force. Mainly the United States of America and Western Europe have recently implemented several restrictions to stop illegal migration, which turns people into criminals when entering their countries without permission. At the same time, this economic crisis has caused a volatility in the exchange rate market. Countries trying to offset the loss of competitiveness that appreciations bring with, intervene in the exchange rate market contributing to a currency war.

Several economic actors who trade in foreign currency see themselves seriously affected by the nominal exchange rate (NER) volatility. A sudden appreciation of the NER makes exports less competitive but relieve debtors who can buy foreign currency cheaply. On the other hand, a depreciation can make a dent in debtors and importers budgets but it benefits exporters and families receiving remittances, since their income in terms of local currency increases. In this paper, we

analyzed whether or not households receiving remittances become better off in real terms by a currency depreciation. Thus we pose the following questions: to what extent does the economic crisis of 2009 affect remittances in Latin America? How has the USA confronted the problem of illegal immigration and what is the main cause of this policy? How have anti-immigration laws, the economic crisis and exchange rate affected the recipient families of remittances in Mexico? What have been the effects of exchange rates volatility in the purchasing power of families receiving remittances? To answer these questions we have divided our paper into four sections. Section I gives a snapshot of the consequences the *Great Recession* (Krugman, 2009; Stiglitz, 2010) had in remittances flowing to Latin American and the Caribbean. Section II outlines the main changes in US immigration policy, especially the recent antiimmigration laws and their side effects in Mexico. In Section III we analyzed the importance of remittances in the Mexican economy and foreign exchange reserves, the correlation between NER volatility and remittances and the purchasing power of remittances in terms of food and fuel, taking as an example the price of tortillas and gasoline. In Section IV we explain what kind of strategies families depending on remittances have implemented in order to offset an income drop caused by the Great Recession. Section V summarizes and draws the main conclusions of this analysis.

Remittances in Latin America

The 2009 economic crisis considerably affected several countries of Latin America and the Caribbean, mostly those for which the share of remittances amounts to more than 10% of their GDP like El Salvador, Honduras, Guatemala, Nicaragua, Haiti and Guyana. Haiti, for instance, received 2.1 billion (bn) USD in 2010 an equivalent of more than 25% of its GDP. According to FOMIN (2009), the flow of remittances to Latin America diminished by 15% in 2009 as a consequence of the economic crisis. However, the depreciation of national currencies made it possible to increase the amount of remittances in terms of local currencies, counterbalancing the losses. Between 2002 and 2008 remittances increased from 31.2 bn USD to 69.2 bn USD or by 17% (FOMIN). Other sources such as the BID, state that Latin American remittances went from 28 bn USD in 2002 to 64.9 bn USD in 2009 (MDZ). Because of the 2009 economic crisis, this amount dropped by 15%, descending from 69.2 bn USD to 58.8 bn USD. Also the number of transfers diminished from 15.3 money orders a year in average in 2008 to only 12 money orders during 2009. Of all the countries receiving remittances in Latin America and the Caribbean, Mexico was the most affected in 2009 with a drop of 16%. Central American Countries registered a contraction of 9%, whereas the Caribbean, the Andean Region and South America experienced setbacks between 11% and 12%, except in the case of Brazil where remittances fell by 20% due to the return of a great number of immigrants who were enticed by the Brazilian Economic boom, as well as the loss of opportunities in the host countries. The government of Japan for instance, refused to renew the working visa for Brazilian immigrants. The Brazilian workers who came back home, brought savings with, propping up the amount of remittances in 2011 to almost 2.1 bn USD. It is worth mentioning that the main destinations of the majority of Latin American immigrants are The United States, Japan and Europe, especially Spain. Since those countries were affected by the crisis with a time span, the effects in remittances were, as well, different. Countries like Ecuador, for example, where remittances are distributed half and half between the United States and Spain, experienced a fall in money orders proceeding from the United States, but an increase by those coming from Spain.

The economic crisis depleted an important number of jobs in sectors where immigrants are usually employed like construction and agriculture. Many immigrants who were laid off, looked for alternatives in other sectors like sales and service. Employment for Latinos decreased by 3.71% on average during the first three quarters of 2009. By August 2009, the unemployment rate among Latinos skyrocketed to 13%. A poll directed by FOMIN shows that 25% of immigrants who had lost their jobs still sent money back home to their relatives. The same source states that in spite of the losses in employment, the average income of immigrants in the US didn't change throughout 2009. It has been observed that the amount of money sent by immigrants has a seasonal behavior; it is usually higher during traditional festivities like Christmas and Mother's Day; however, this amount also decreased by 15% in 2009.

In 2011 remittances grew by 6% reaching 61 bn USD. Almost three-fourths of the regional remittances came from the United States and only 12% from Spain. This rebound can be attributed mostly to the economic recovery of the US economy, since the number of foreign workers in Spain

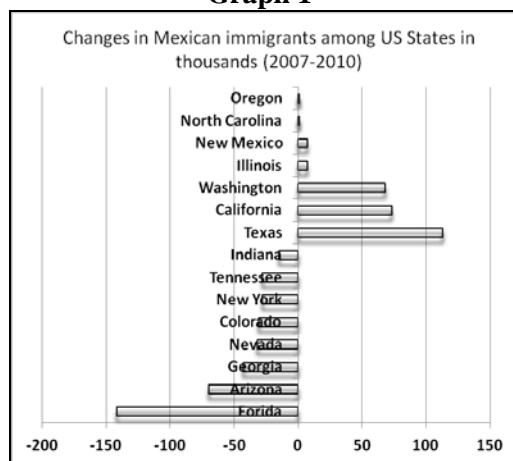
has diminished up 2009 by 2%. To begin with, this improvement in 2011 benefited Mexico and Central America which experienced an increment of 6.9% and 7% to reach 22.7 bn USD and 13.1 bn USD respectively. Secondly, Guatemala and El Salvador are the most important recipients with 4.3 bn USD and 3.6 bn USD respectively. Exchange rate variations benefited those countries which saw their currencies depreciate like Mexico whose remittances value in local currency increased by 17.5%. Countries like Brazil whose Real appreciated lost 15% of the value of remittances.

US Economic crisis and Mexican immigration

Illegal workers are the most vulnerable to economic crisis, but at the same time, they are the first to get back to work as soon as the economy rebounds. The construction sector, for instance, lost more than 600 000 jobs, downsizing the share of Mexicans from 25% to 17% in 4 years. Due to the recent economic recovery, the construction sector has reached the bottom line and has, ever since, begun to stir up again. Other waning sectors affecting Mexican workers have been tourism and entertainment as well as manufacturing with more than 100 000 and 150 000 fewer jobs between 2007 and 2011. These workers have found opportunities in sectors like services, education, health, agriculture, fishing, and forestry and information technology. Mexicans of second and third generation have lost their jobs in construction and found new chances in the mentioned sectors as well as entertainment and tourism. This phenomenon is not new; Hilary (et. al, March 2011: 21) states, for example, that the economic crisis in the USA from 70's onward have particularly affected men, black and Hispanic workers. This is due to the fact that these groups are normally employed in highly cyclical industries such as construction and manufacturing. The already unusual 99 weeks long unemployment insurance benefit, represents an evidence that the US economy is facing a long-term unemployment problem.

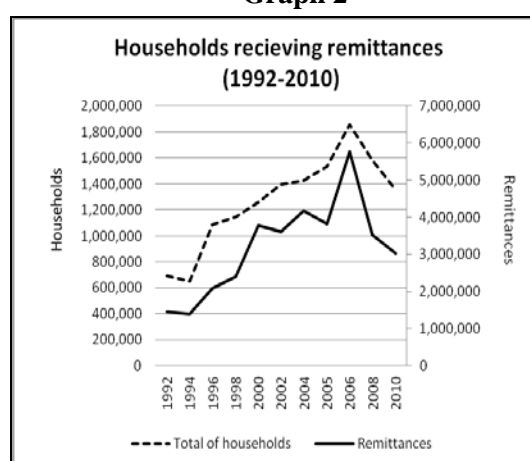
It is estimated that Mexican immigrants are concentrated in US States like California, Texas, Illinois, Arizona, North Carolina, Georgia, Florida, Washington New York, Colorado, Nevada, Oregon, New Mexico, Indiana and Tennessee. According to BBVA (junio de 2011), Mexican immigrants have left those US States where laws against illegal immigration have been issued. That is the case of the SB2040 in Florida approved on the May 3, 2011, by which authorities verify immigrant status of those who apply for public services or when detained by the local police because of a minor felony. If that person is illegal, he or she can be sent to the immigration office and be deported to her o his country of origin. This law was planned to be enforced on of July 1, 2011. In Indiana, the Congress approved the SB590 law on May 10 to be enforced by July 1, 2011, by which any person incurring a minor problem, even a traffic incident, can be arrested. Enterprises of this state working for the government will use an E-Verify system to monitor their associates and make sure they are not illegal immigrants. The governor of Georgia issued the HB87 law on May 13, which entitles the local police to check the migration status to anyone who breaks the state law, or punishes people who shelter or transport illegal immigrants. In Alabama a law was passed June 3 that allows the local police to stop any car or citizen suspicious to be an illegal immigrant; immigrant have therefore left Arizona, Florida and Georgia.

Graph 1



Source: BBVA (Junio de 2011).

Graph 2



Source: CONAPO (2012).

As we can see in graph 1, more than 140 000 immigrants left Florida, 70 000 Arizona and 40 000 Georgia between 2007 and 2010. Many have moved to neighboring States like New Mexico, Texas and North Carolina. Other States like Oklahoma are discussing laws like the HB14462 by which any passenger travelling in a public or private transportation could be stopped to be asked about his or her immigrant status. Besides the fact that employers would have to verify the immigrant status of his associates, the state of Oklahoma could be entitled to confiscate any assets belonging to an illegal immigrant like cars, houses, money, etc. The State of Tennessee was discussing the HB1380 law to be approved in 2012 by which anyone committing a crime or being suspected to be an illegal immigrant can be arrested.

This policy has begun to affect Mexican immigration. According to Passel (et al, 2012: 9), deportations of unauthorized Mexican immigrants – some of them picked up at work sites or after being convicted for other criminal violations – have risen to record levels. In 2010, 282 000 illegal Mexican immigrants were deported to Mexico. The same source affirms that the number of Mexicans trying to cross the border illegally dropped from 1 million in 2005 to 286 000 in 2011. Border Patrol apprehensions are now to the 1971 levels.

According to BBVA (Junio 2011), the growth of Mexican population in the US from 2002 to 2005 was fostered mainly by an increasing number of immigrants, while the second half of the 00's the children of Mexicans born in the USA led that growth. Passel (et al, 2012: 9) states that from 2000 to 2010 births of Mexicans in US surpassed immigration as the main reason for growth in the Mexican-American population⁸⁵. The BBVA (Junio 2011) report reveals that 55% are men and 45% women; the share of immigrants younger than 30 years old has diminished, whereas that between 30 and 64 years old has grown whereas the group over 64 has remained stable. The average age of immigrants grew by 3 years from 2000 to 2010 ending at 37 years old. The same source points out that Mexican immigration to the USA not only has diminished due to the economic crisis and the laws against illegal migration recently passed in the USA, but has unleashed a wave of Mexican returnees back home. It is estimated that from 2007 to 2011 the number of illegal Mexican immigrant has remained in 11.8 million. This information seems to coincide with Jeffrey Passel's (et al, 2010: 11-15) report. He points out that the Mexican-born population grew 23% from 2000 to 2005, peaked in 2007 at 12.6 million and stabilized for two years before declining slightly in 2010. In 2011, the Mexican born population in the U.S. decreased still further, to 12.0 million; 58% of them are estimated to have an illegal status. Passel (et al, 2010: 17) estimates that 5% to 35% of 1.4 million Mexican adults who returned back to Mexico between 2005 and 2010 may have been forced to do so, either by deportation or expedited removal processes. An interview applied in 2010 showed that 20% of the repatriated Mexicans said they would never go back to the USA, while only 7% gave the same answer in 2005. He also writes, that the annual inflow of Mexican immigrants to the US went from 370 000 in 1991 to 770 000 in 2000, but from that year on that number started to decline sharply to only 150 000 in 2009 and even lower in 2010. He thinks that the return flow to Mexico might have exceeded the inflow from 2009 onwards.

The number of household receiving remittances went from 692,676 in 1992 to 1,858,758 in 2006, which equals a yearly average growth of 7.31%. Its share in the total Mexican households grew from 3.7% in 1992 to 4.7% in 2010, but it reached its highest participation in 2006 with 7%. That means, it dropped between 2006 and 2010 by -27%, going from 1.858 to 1.3 million or from 7% to 4.7%. This fall can be explained by a higher number of Mexicans losing their jobs as a consequence of the economic crisis. According to BBVA the rate of unemployment among Mexicans went from 5.5% in IIQ07 to 12.9% in IIQ09, while for the average American worker the same indicator was 4.5% and 10% respectively. Conversely, the amount of remittances grew at an annual rate of 15.32% going from 3 bn USD in 1992 to 26 bn USD 2006. The steepest increments were scored in 2003 and 2001 with 54% and 35.3% respectively and both were related with a US economic take off.

The BBVA (Junio 2011: 25-29) report shows that the primary receivers of remittances are households living in rural areas. The Federal State of Zacatecas scored the highest in terms of receiving remittances in 2010, with 11%, followed by Michoacán, Nayarit, Guanajuato and Guerrero. At the same time, Zacatecas showed the highest share of households (17%) benefiting from foreign

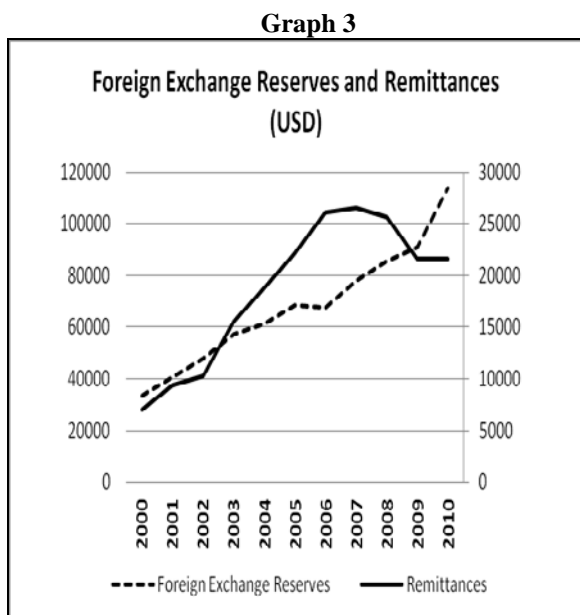
⁸⁵ Passel (et al, 2012: 35) states that Mexican born immigrants are younger, less educated and less likely to speak English very well in comparison with other foreign born residents of the USA.

money transfers, followed by, Michoacán, Nayarit and Jalisco. This same report found that more than 50% of the households led by women and receiving remittances were in Tabasco (60%), Distrito Federal (52%), Tlaxcala (51.6%), Veracruz (50.9%) and Hidalgo (50.1%). The national average being 45.0%, Durango, Campeche und Baja California showed the lowest share: 36.3%, 36.4% and 37.5% respectively. The same report states that these households don't belong to the poorest levels classified as *marginalized population*, but to the low-income tenths. As a matter of fact, by plotting the percentage of households receiving remittances against the marginalization level, we observe an upside down "U" shape, meaning that as income increases the majority of these households receiving remittances are located in the middle levels of marginalization. However, there are families for whom remittances are of the highest importance and therefore, become vulnerable to external shocks. CONAPO (2010: 48), for example, states that the share of households depending on remittances for more than 75% of their whole income reached 16.5% out of 1.1 million households registered in 1996. In 2006, when the number of families receiving remittances scored 1.9 million, this share was 13.8%. In 2008 the proportion fell to only 6.3%. This significant drop is attributed to the fact that most of the families who stopped receiving remittances were those depending on them for more than 75% of their income. Finally, it is important to emphasize that remittances make at least 50% of the whole rural households' monetary income.

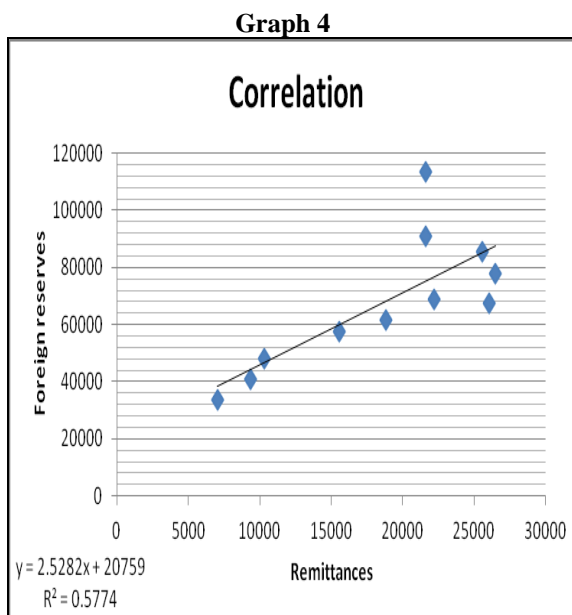
Changes in remittances' purchasing power

Sources quoted at the beginning of this paper, posed the hypothesis that exchange rate depreciation had positive effects in purchasing power in terms of local currency and therefore, higher unemployment and a decline in remittances, were partly offset by a depreciation of the local currency, allowing the correspondent households to acquire more goods and services at the domestic market. According to the BBVA report (Marzo 1, 2012), Mexican remittances grew by 7.2% annually in January 2012, and twice as much in terms of pesos. The annual amount totaled 22.8 bn USD, which is 2.2 bn USD above the level reached before 2007 and 3.2 bn USD below its highest record in December 2007. This rebound is explained by the fact that more than 50% of the jobs lost during the crisis in the USA have been recovered and 20% of them have been covered by Mexican immigrants.

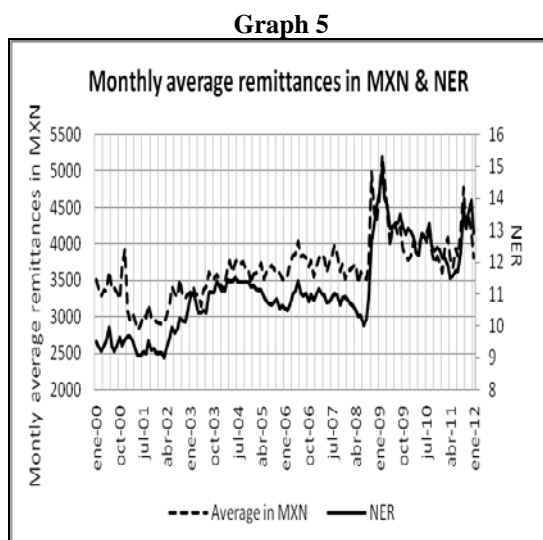
As we can see in the graphs 3 and 4, remittances have been growing along the 00's, supporting the appreciation of the MXN through an increasing amount of foreign reserves. The Pearson correlation between foreign reserves and remittances equals 0.75 or a R^2 of 0.57, which means they are highly correlated. According to the equation in bottom left side of graph 4, for every billion USD increase in remittances, the foreign reserves of Mexican Central Bank are augmented by 2.5 billion USD. Conversely, the monthly amount of remittances in terms of MXN and the NER has a Pearson correlation of 0.87. A regression between the two variables states $y = 594.9 + 276.7x$, which means that for every unit that the MXN depreciates against the USD, the average nominal value of remittances increases by 276.7 MXN as plotted in graphs 5 and 6. It is also evident that the economic crisis, which triggered a depreciation of the MXN by almost 40% at the end of 2009, increased the monthly average amount of remittances in terms of local currency. That also occurred at the end of 2011, as we can see in graph 5. The 27% drop in the number of households receiving remittances between 2006 and 2010 was supposed to be counterbalanced by a more powerful dollar resulting from a depreciation of the NER. In order to see whether or not, these families obtained a better purchasing power, we must match that income with prices of products these families buy everyday. According to the Economist, (January 5th 2008: 11), 90% of remittances worldwide are spent on consumption. In Mexico, CONAPO (2010: 66) reports that more than 80% of remittances are used to buy food, pay rent or repair the house; only 6.5% are used to set up a business or to buy a property, and another 5% to pay debts.



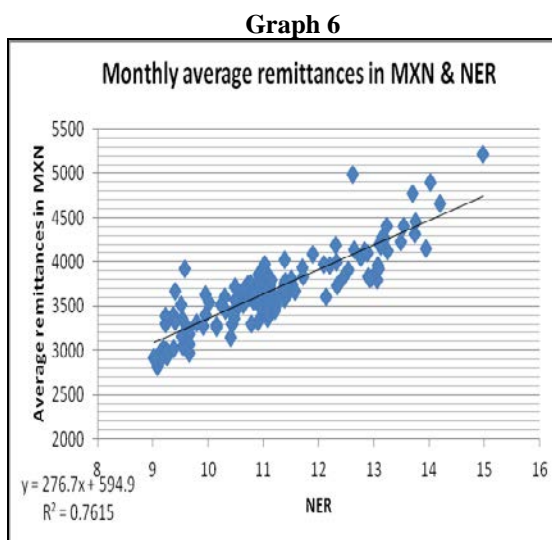
Source: Banxico (2011) Informe anual 2010.



Source: Banxico (2011) Informe anual 2010.



Source: Banxico (2012) CE81 ingresos por remesas.



Source: Banxico (2012) CE81 ingresos por remesas.

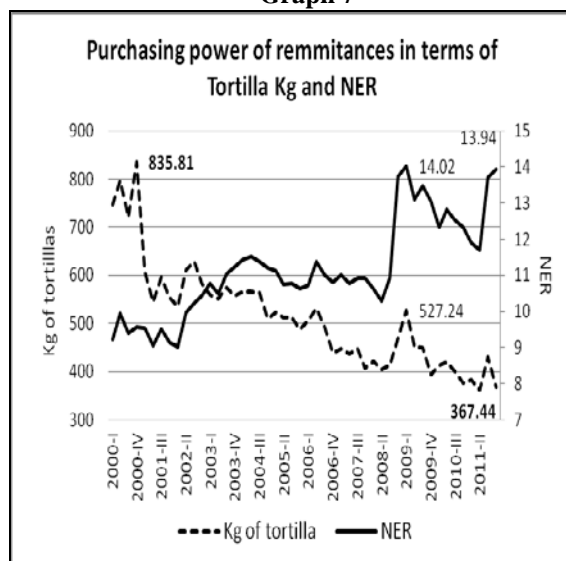
To conduct this analysis we have chosen two leading items of the Mexican basic consumption basket: energy (gasoline and Diesel) and Tortilla. According to the INEGI (julio de 2011: 15) households' income is composed by 75% cash and 25% in kind. For instance, food, beverage and tobacco represent 33% of the monetary expenditure, whereas transportation represents 18.5%, making both together 50% of the expenditure. According to Irma Martinez (2003: 31), Tortilla appears in the first place among the 20 most important food products bought by an average Mexican family nation wide and it is essential to the poorest people's diet. Eventhough both products, Tortilla and fuel, are heavily subsidized by the government⁸⁶, they still represent a strong driving force by which prices of a great variety of products in the food chain and transportation change. Mexican Central Bank (Banxico, 2011: 38) acknowledges a high rate of inflation in food, beverage and

⁸⁶ The total governmental expenditure to subsidize gasoline and Diesel from 2007 to 2011 was 530.23 bn MXN. In times where international oil prices are high, the subsidy increases, since more than 40% of the domestic consumption of gasoline must be imported. At the IQ12 the subsidy for gasoline and Diesel was 51.5 bn MXN, an amount that had already surpassed the whole budget for that year. So it is highly probable that energy domestic price increases continue in the future. The Secretary of Finance (SHCP) states that 50% of this subsidy benefits 20% of the population with high income, whereas only 4% on the population with low income take advantage of this governmental aid (El Financiero, 2 de mayo de 2012: 3).

tobacco. This soared to almost 10% annually at the beginning of 2008 and went below 4% at the end of 2009 but rebounded again to reach more than 7% in December 2011.

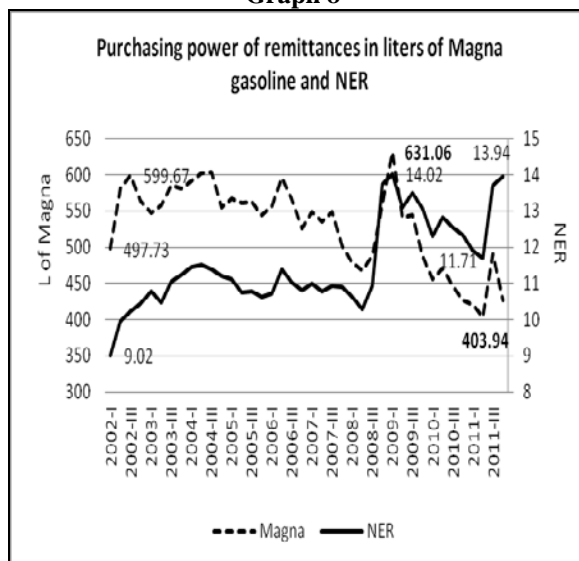
In 2008 and 2010 international prices of basic grains like wheat, rice and corn increased as a consequence of the food crisis. Prices of energy and precious metal soared as well; therefore, even though remittances increased in terms of MXN due to the depreciation, that did not mean the households could automatically acquire more goods and services. In order to gauge to what extent the depreciation of MXN meant a higher purchasing power for the respective households, we must match that income with price increases in Tortilla and gasoline. Based on the average monthly amount of dollars⁸⁷ sent by immigrants to their families in Mexico as plotted in graph 5, we can estimate the purchasing power in terms of food and energy. For instance, in graphs 7, 8, 9 and 10 we can see the behaviour of NER and the purchasing power of remittances in terms of Tortilla Kilograms (Kg), liters (L) of Magna gasoline, L of Premium gasoline and L of Diesel. In all items a depreciation of the NER seems to be reflected by substantial loss of purchasing power, except during 2008-9 when the crisis struck the hardest.

Graph 7



Source: Banxico (2012) CE81 ingresos por remesas.

Graph 8



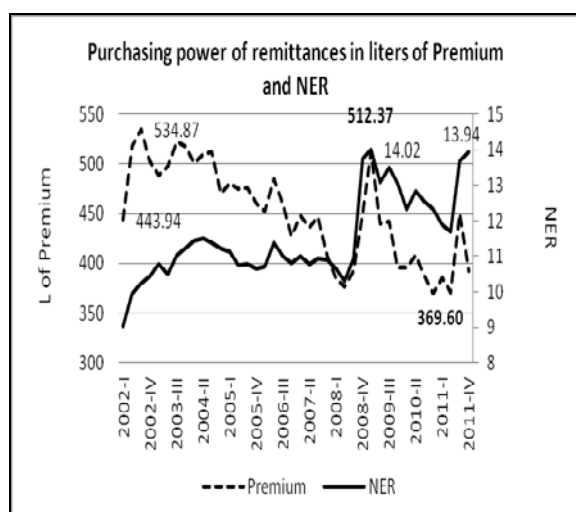
Source: PEMEX, indicadores petroleros.

From IVQ00 to IVQ11 the average monthly amount of remittances declined by -27.28% going from 409.61 USD to 297.85. At the same time NER depreciated from 9.57 MXN per USD to 13.94 or by 45.66%. In terms of MXN this represented an increase of only 5.92%, going from 3920 MXN to 4152 MXN in the same period. However the price of a Kg of Tortilla rose from 4.60 MXN/Kg to 11.30 MXN/Kg or by 145%. Dividing the amount of remittances by Kilograms of Tortillas, we see a loss of 56% as shown on the left side of graph 11 since households could buy only 367.4 Kg of Tortillas in IVQ11 instead of 835.8 Kg as they did in IVQ00 (see also graph 7). By extrapolating values, we can say that households could buy 631 L of Magna gasoline in IQ09 when the average NER was 14 MXN per USD, but at the IIQ11 they could only afford to buy 404 L, a loss of 36% (graphs 8 and 11). For Premium and Diesel, households could buy 512 L and 729 L in IQ09 and IIQ04, but 369.60 L and 389.53 L in IVQ10 and IIQ11 respectively, a loss of 27.8% and 46.5%. As shown in graph 11, the largest purchasing power loss these families had, was of Tortillas, followed by Diesel, Magna and Premium.

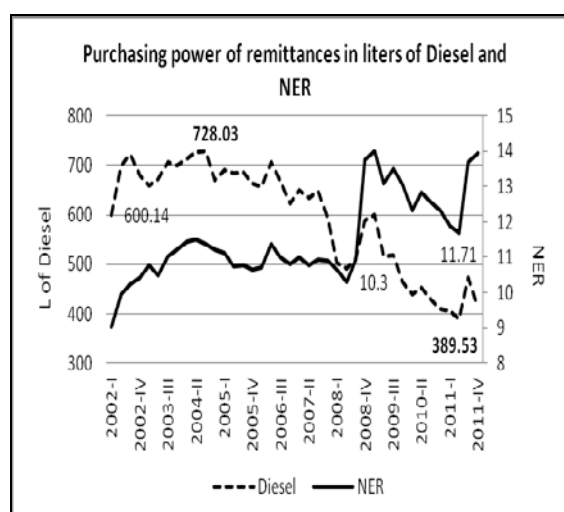
Graph 9

Graph 10

⁸⁷ The net amount is highly controvertible. But we use here data published by the Mexican Central Bank. CONAPO, (2010: 51-52), for example, states that the average annual remittances amounts 2000.00 USD per family in the rural sector and 2400.00 USD in the non rural sector. The same source specifies that the yearly amount of remittances in rural sector increased from 496 million USD in 1992 to 1,350 million USD in 2008, whereas non rural sector went from 968 million USD to 2,176 million USD in the same period. In year 2006, both sectors reached their highest level with 2,705 and 3,058 million USD respectively. Finally, additional cuts resulting from commission charged by businesses like Western Unions must be considered as well.



Source: PEMEX, indicadores petroleros.



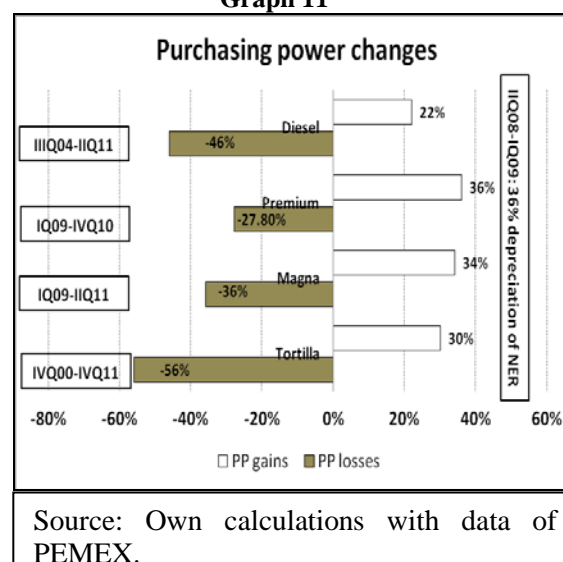
Source: PEMEX, indicadores petroleros.

Table 1

Correlation NER vs Tortilla and fuel			
Item	Slope	Pearson C.	R ²
Tortilla 00-11	$y = -47.941x + 1048.1$	-0.60	0.35
Magna 02-11	$y = -11.07x + 657.87$	-0.22	0.05
Premium 02-11	$y = -10.866x + 575.84$	-0.26	0.07
Diesel 02-11	$y = -50.238x + 1172.4$	-0.54	0.29

Source: Own calculations with data of PEMEX

Graph 11

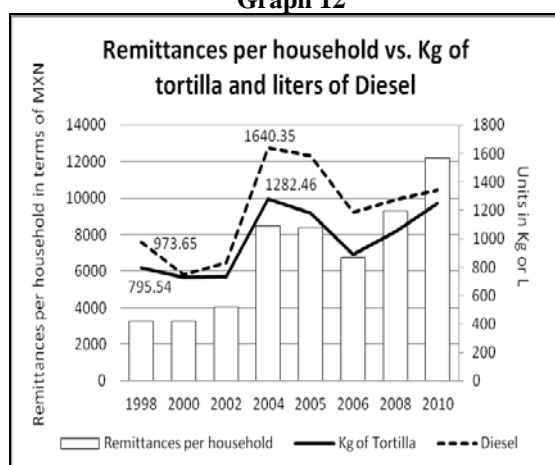


The items we have chosen are inversely correlated with the NER. That means that as the nominal exchange rate depreciates, purchasing power diminishes. Table 1 shows that Tortilla has the highest correlation with -0.60, followed by Diesel: -0.54; Premium: -0.26 and Magna -0.22 with their respective R²: 0.35, 0.3, 0.070 and 0.052. Supposing all money from remittances are used to buy these items separately, we can say that for every unit the MXN depreciates, households lost purchasing power in terms of 48 Kg of Tortillas, 50 L of Diesel, 10.8 L and 11 L of Magna. This means that the largest price increases have taken place in Tortilla and Diesel. Apart from Tortilla, beans, white bread, chicken, tomato, sugar, milk and vegetable oil scored the highest price hikes between 2006 and 2011, affecting the purchasing power of the lowest levels of income. Diesel is used by a broad number of economic actors under which logistics and trucks have been most affected.

On the other hand, graph 11 shows on its right side how a 36% depreciation of NER between IIQ08 and IQ09 allowed families to improve their purchasing power by 36% in Premium; 34% Magna, 30% Tortilla and 22% Diesel. But this windfall could not offset the losses accumulated between the highest and lowest purchasing power levels pointed out on the left side of the same graph, except for Premium with a net gain of 8.2%. This effect was the result of the fact that prices rose more rapidly than the purchasing power of the MXN derived from the NER long term depreciation, except for the period between IIQ08 and IQ09, when a severe depreciation came so unexpectedly that domestic prices could not catch up.

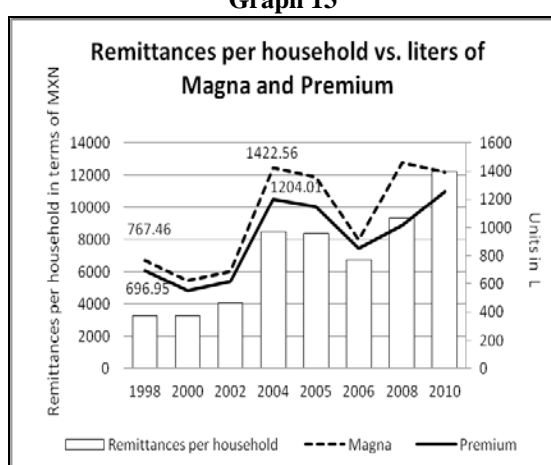
There is still an aspect that could change the view of this analysis substantially. As we stated before, the number of households receiving remittances dropped by 27% going from 1.85 million in 2006 to 1.35 million in 2010, while remittances on a yearly basis also fell, but only by 16% from 25.5 bn USD to 21.3 bn USD in the same period. If we divide the amount of remittances by the smaller number of households, we come up with a higher amount of income per head. Graphs 12 and 13 show how a fewer number of households receiving a higher amount of remittances in terms of MXN due to the depreciation were able to buy more units of tortillas and fuel. Especially in the case of tortilla and diesel, where the aforementioned analysis showed a substantial loss, there is a clear betterment of the purchasing power from 2006 onwards. The recovery is stronger by Magna and Premium as graph 13 shows. Calculating the monthly amount of remittances from this angle we come to a quiet different result. For instance, the average monthly amount⁸⁸ rose from 408 USD (3,718.35 MXN) in 1998 to 1322 USD (14,736.85 MXN) in 2008 and to 1308 USD (16,494 MXN) in 2010, which is a lot more than the statistics that the Mexican Central Bank and INEGI report. This is an open question that has still to be addressed since it might have to do with high levels of inequality or the participation of organized crime, both factors capable explaining why monthly remittances could be that high.

Graph 12



Source: Banxico and INEGI.

Graph 13



Source: Banxico and INEGI.

Effects of remittances on employment and education

If households receiving remittances had a real net loss either by a smaller amount of remittances; by an interruption of any help from abroad or by a deterioration of their purchasing power as the above analysis shows, they must have looked for alternatives to redeem these losses. According to CONAPO (2012: 45-47), the share of remittances in the total monetary income of the correspondent households soared from 44% in 1992 to 53% in 1996. The following years it dropped going from 40% to 48%, except in 2008 where it reached 27% due to the economic slump. But households seemed to have found ways to counterbalance variations in the flow of remittances. For example, the share of remittances in comparison with other sources of income (e.g. non monetary income; own business, and salaries) was 40% in 1996; 33.6%: 2006: and 21.2%: 2008, while the share of job retributions and revenues from their own business in the total income was 18.3%, 25.2%: 1996; 29.5%, 9.8%: 2006 and 9.9%; 11.9% in 2008. This effect was even larger in the rural sector. That means that family members started to work or set up a business as they saw the flow of remittances languish. However, we must notice that none of them could fully substitute the importance that remittances had in 1996. Since some households could have stopped receiving remittances completely, we can observe a general deterioration of their standard of living.

In this same context, a research conducted by BBVA (junio 2011:17-24) using the *logit* and *probit* models find a relationship between remittances and employment as well as remittances and school attendance. The results point out that the probability of a household finding a job reduces by between 7 and 8 percent if it gets money from abroad. This was observed in both genders, either male or female, running a household, but more intensively by those in which the responsible was a male.

⁸⁸ Remittances in 2008 amounted 25.134 bn USD; households were 1.58 million, which means that every household received an average of 15 874 USD or an equivalent of 1322.88 USD monthly.

The same report states that between 2007-2010, the number of women belonging to these households and started to work, increased by 3%. CONAPO (2010: 59) states that the number of families led by women increased constantly along the 00s, and in 2006 there were almost 964 000; two years later and as a consequence of the economic crisis, this number was reduced to 738 000, which suggests that the most affected households were those led by women. On the other hand, BBVA (junio 2011:17-24) states that municipalities with high rates of remittances reception show at the same time, high levels of unemployment. Two hypotheses attempt to explain the phenomenon; on the one hand, people receiving remittances are less motivated to work, making it easier for the rest to find a job and therefore showing sinking levels of unemployment; on the other hand, the smaller the number of people working, the less is produced and the less the labor force is required.

In respect to the effect of remittances in school attendance, the same report found a positive relationship between remittances and school attendance among children below 15 years old and youths between 15 and 19 years old. Other estimates coincide with the results leading to the conclusion that remittances have fostered the formation of human capital, which at the same time constitutes a significant contribution to long-term development (Sachs, J.: 2005). However, an other important finding was that middle levels of education seem to foster immigration more intensively than higher ones. Thus, the report concludes that education and reception of remittances have a positive correlation. That means that remittances allow and animate households to send children to school, opening them up a chance to immigrate when they reach the middle levels of education. That will assure, at the same time, the future reception of money from abroad. Recent data have shown that immigrants older than 15 living in the United States have an average of 9 years of school attendance. If this effect supersedes the former, the long term human capital formation in Mexico that remittances seem to foster could be counterbalanced through a brain drain process. However, this seems to be a world tendency; according to *The Economist* (5th June, 2008: 5), the World Bank found that 32% of 52 million immigrants in 2000, had a college education, a share which represented a sharp rise in comparison to a decade earlier.

Conclusion

On April 25th 2012, the Mexican President Felipe Calderon Hinojosa, stated in a G-20 Summit in Washington, that Mexican immigration to the USA had come to a halt in net terms, due to the fact that employment opportunities and health services in Mexico had substantially improved. That might be the case of Brazil, since our paper does not seem to support the President's declarations. The present analysis shows that immigration has indeed diminished through two mechanisms, by the drop in the annual number of people leaving for the US and by an increasing the number of Mexican returnees. However, this drop is the consequence of the recent anti-immigrant laws and the Great Recession in the USA. Of course, other factors like the decline in Mexico's birth rates and a slight economic improvement in some regions might have also played a role. But in general, the unemployment rate in Mexico has remained above 5% annually since the Great Recession broke up in 2009; a level that is still very high when compared in length with the 1995 recession. If we take into account that 28.8% of the working population is employed in the informal sector, and more than 7 million young people neither work nor study, it is hard to support the hypothesis that better labour conditions have stopped immigration in the last years. Immigration has diminished, but it is still an important alternative for many Mexicans to improve their income and help their families. It depends more on the USA economic performance than the dynamic of the domestic labour market.

Remittances and immigration will eventually rebound as the US economy starts to overcome its present structural crisis. Remittances alone cannot be by themselves the main development factor, but they have proved to be until now a powerful driving force to deter or reduce poverty in Mexico. CONAPO (2011: 64) for example, points out that a 30% drop in remittances would condemn 30 000 Mexican households to poverty. Those families for which remittances do not represent the main source of income normally strengthen their economic status by acquiring tangible assets like property and business. The present essay posed the hypothesis that NER depreciation translated to an increase in purchasing power in terms of local currency, which at the same time meant an improvement for families receiving USD from abroad. As we saw based on domestic price changes of Tortilla and fuel, the additional nominal income derived from such depreciation was offset by a larger domestic price increase, so that at the end, households became poorer. An additional factor which might have worsened the families' income was that remittances lowered in average and that several household

stopped receiving them all together. An exception took place during 2008-9, where NER depreciation allowed families still benefiting from remittances to buy more units of Tortillas and fuel, as prices could not adjust so rapidly.

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COSTING METHODS FOR SUPPLY CHAIN MANAGEMENT

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Abstract:

Today's organizations, operating in an increasingly competitive conditions, are characterized by a network of relationships with suppliers and customers. Thus, the key resources, being a source of competitive advantage, are located not only within the organization but are part of network relationships. The most important task of managers is to achieve supply chain cost efficiency while maintaining high flexibility.

This article focuses on the potential role that management accounting information can play in supply chain management. It describes key methods that can be used in practice to implement management accounting practices that facilitate effective supply chain management.

Key Words: Cost management, costing, supply chain management

The Concept of Supply Chain Management

Over the past two decades, Supply Chain Management (SCM) has come to be regarded as one of the key factors of competitiveness and organizational effectiveness (Porter, 1985; Jones, 1989). Supply chain management is a major concern in many industries as companies are aware of the importance of integrated relationships with suppliers and customers. The pressure of global competition and the need for broad inter-organizational cooperation forces companies to take action to improve supply chains, so that they are flexible and responsive to change.

Key resources which are the source of competitive advantage, are located not only within an economic entity but are part of a network of relationships. This relative perspective of perception of the firm suggests that individuals critical resources can be embedded in the procedures and processes constituting inter-organizational network of relationships.

At present organizations are competing rather at the level of effective flow of materials, intermediates and products to customers throughout the supply chain than at the level of efficiency of the production process. This perception of supply chains and their pursuit of continuous improvement are an important factor of profitability.

The literature on the subject cites various definitions of supply chain management. Among the commonly used is the definition formulated by Handfield and Nichols (1999), according to which: the supply chain encompasses all activities associated with the flow and transformation of goods from the phase of acquisition of materials, through successive stages up to the end user, as well as activities associated with the flow of information. Resources and information are moving up and down the supply chain. Supply chain management is the integration of these activities through the improvement of supply chain relationships in order to achieve competitive advantage.

In other words, the supply chain management can be perceived in three dimensions: it is the administration of activities and processes, coordination of business functions in an enterprise (inter-functional) and the inter-organizational coordination.

Administration of activities and processes has much in common with the logistics management and refers to activities such as transportation management, inventory, warehousing and order management, which are the responsibility of the logistics function. Inter-functional coordination refers to cooperation and building relationships with other functional areas within the same company, such as marketing and finance areas. Inter-organizational coordination concerns collaboration and coordination of products flow between the participants of the supply chain. Supply chain management is thus seen as a product flow management in many companies, while logistics management is only seen as the product flow operations within the separate company.

The concept of supply chain management has been formed as a result of progressive evolution, as shown in Figure 1.

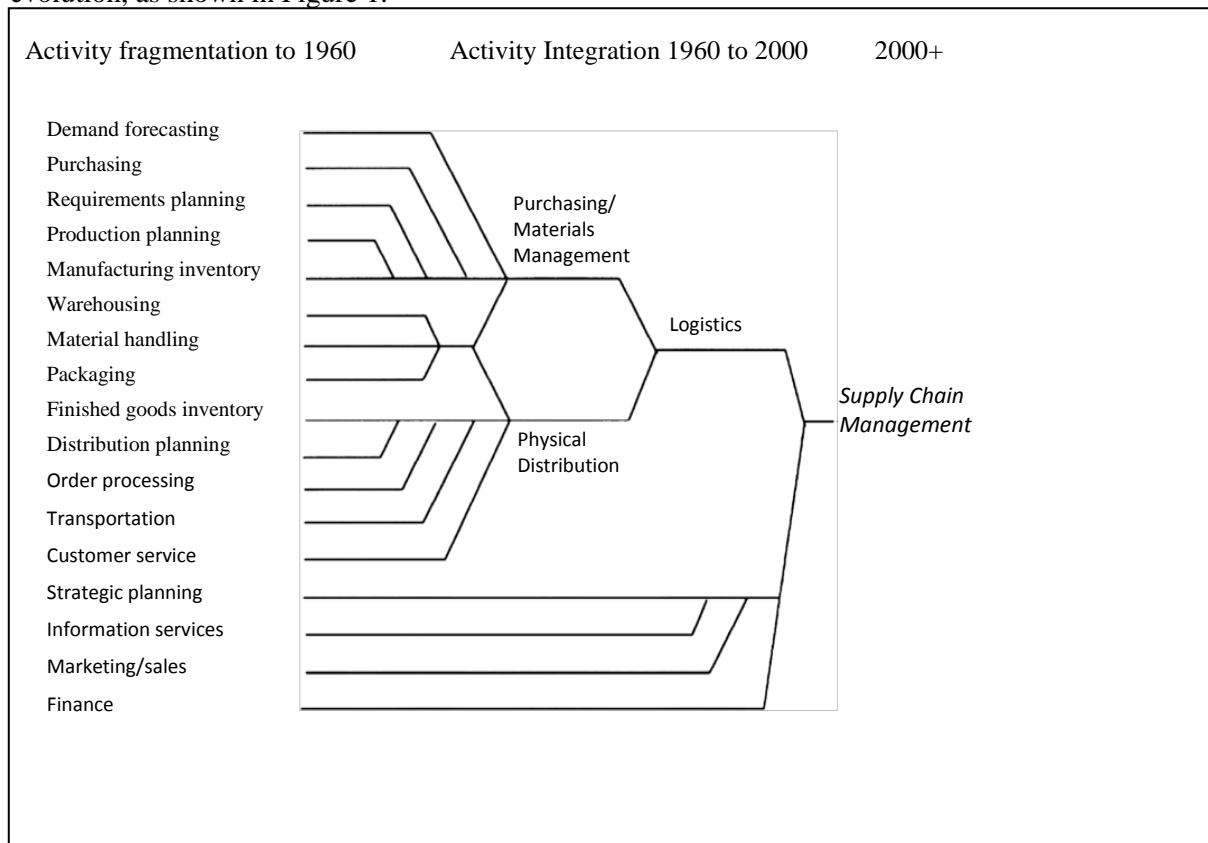


Fig. 1 – The evolution of supply chain management. Source: Ballou, 2007.

Currently, SCM is perceived as a set of management processes, where the process is defined as a group of activities important to achieve a specific purpose, such as order fulfillment. All these processes constitute the whole of SCM. These processes should be coordinated through collaboration and relationship management throughout the supply chain, from the initial suppliers to final consumers.

Supply chains should be managed in an integrated way. Integrated approach to supply chain management focuses on managing relationships, information and material flow in the inter-organizational dimension in order to reduce costs and improve flows. Companies using integrated concept of supply chain management are looking for ways of integration of its logistics, procurement, operational activities and marketing functions with other participants in the supply chain, so that the flow of materials, information, components and finished products run smoothly from point of origin to the end user, providing a low cost of unit and a high level of service.

Functioning of the organization in an integrated supply chain contributes to gaining competitive advantage and at the same time meets a greater extent of customer requirements in the field of on time delivery and quality of products and services.

A significant reconfiguration of operation conditions of the organization poses challenges for traditional management accounting, which was primarily to control costs and improve performance mainly through the use of conventional methods, such as traditional cost accounting and budgeting. In terms of integrated supply chains, these methods are inadequate and largely insufficient.

With the increased competition value creation became therefore a function of effective relationships with suppliers. The supply chain is a network of such relationships. Its operation is based on the creation of a reliable and continuous networks of collaboration and a comprehensive thinking, which results in the creation of value. Such co-operation is based on the pursuit of common goals, open communication and information sharing among supply chain participants. Importantly, each participant of supply chain is motivated by a common goal, which is to create value in order to gain competitive advantage.

The functioning of the supply chain raises a number of new challenges resulting from the extended form of organization. A prerequisite for the development of strong relationships along the supply chain is to ensure the effectiveness of cooperation between the supplier and the buyer, the management of communication and negotiation among the participants in the supply chain, exploiting the opportunities offered by the continuous improvement and co-ordination, but also, for example, eliminating opportunistic behavior.

Cost Management of Supply Chain

Cost control is one of the key factors ensuring the financial efficiency.

The financial result, despite the simple formula for its calculation, in fact, is a very difficult value to determine. Further difficulties associated with the proper measurement of financial results occur especially in a dynamically changing business environment (Białas, 2011).

Collection of accurate and adequate information on costs is a key element in the management process both considering the separate company as well as inter-organizational dimension of management. More and more managers are aware of the fact that effectiveness is a source of competitive advantage and are trying to improve and develop the methods of analysis and management of costs and processes. An area where it is possible to achieve significant cost savings is supply chain.

Cost reduction is one of the most frequently mentioned goals in supply chain management. In addition, efforts to reduce costs are forcing companies to focus increased attention on the relationships with other participants within the supply chain, so that both suppliers and customers are able to improve the competitiveness and profitability. In response to these realities the literature on the subject lists the specific concepts of cost management within the supply chain, as shown in table 1.

Tab. 1 – Concepts of cost management of supply chain. Source: Seuring, Goldbach, 2002.

Concept	Characteristics
Supply Chain Costing	Three cost levels need to be analyzed: direct, activity-based, and transactions cost to account for all costs in a supply chain and find the right partner to control them.
Proactive Cost Management	Proactive cost management is a market oriented, anticipatory system. Specific techniques are used to coordinate activities, as a case study from the car industry shows.
Lean Management Accounting	Linking strategic and operational levels to understand customers and processes, and thus enhance customer value. A case study from car sales offers details.
Interorganizational Cost Management	Managing supplier and customer costs in coordinated cost reduction programs are carried out during product design and manufacturing.
Organizational Settings	Cost Management has a functional and an institutional dimension. Principal-agent relationships are important in the application of cost management in a supply chain.

These concepts show that traditional cost management ignores the needs of the supply chain cost management. An important element of the concept of cost management in the supply chain are the two dominant perspectives. The first uses target costing assumptions, determines the way in which goals are set and can be achieved. The second perspective is based on activity based costing. Reference to target costing and activity based costing as the instruments of cost management plays a major role in the presented concepts (Seuring, Goldbach, 2002).

Cost management of an enterprise (so-called intra-organizational cost management) can be described as a portfolio of activities and procedures that enable organizations to manage their internal costs and to make cost decisions. This portfolio in order to manage costs may include a number of measures, applied within its own internal value chain, such as Activity Based Costing, Target Costing and continuous improvement (Kaizen Costing).

On the other hand, in the context of supply chain management, occurs the concept of inter-organizational cost management, described as an extension of intra-organizational efforts to manage costs.

The domain of inter-organizational cost management are buyer-supplier formalized interactions, the objective of which is to identify opportunities for joint cost reduction (Cooper, Slagmulder, 2004). It can be expected that organizations with high levels of internal cost management will be able to use their knowledge and experience to develop similar activities as part of the inter-organizational cost management. The same planning and control skills that are the foundation to manage costs internally may be useful for the wider benefit of all partners in the supply chain.

The business practice shows that particular activities of the internal costs management can be translated into inter-organizational environment. Knowledge and experience in the use of internal cost management tools can be applied to develop inter-organizational cost management tools designed for the supply chain participants to their common benefit. Therefore, the ability of organizations to manage costs internally is an important determinant and the foundation that allows inter-organizational cost management, as shown in Figure 2.

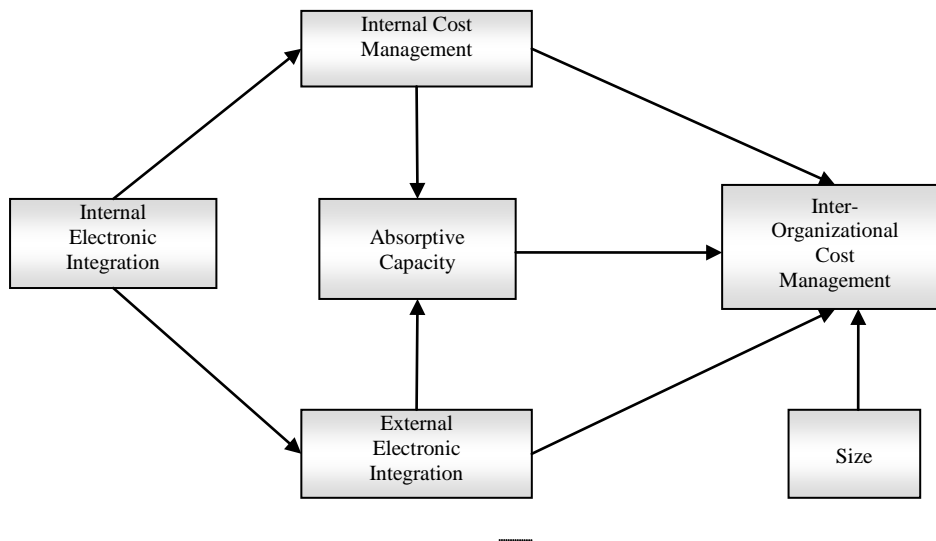


Fig. 2 – Effect of intra-organizational cost management, information systems integration and absorptive capacity of organization on inter-organizational cost management in supply chains. Source: Fayard, at al., 2012

The application of inter-organizational cost management in a company requires the fulfillment of a number of conditions, including:

- determining the specific objectives of reducing costs with regard to suppliers,
- collaboration with suppliers and customers in finding ways to reduce their costs,
- taking into account the profitability of suppliers when negotiating the purchasing price,
- ensure effective collaboration with suppliers and customers.

Due to the far reaching consequences of close cooperation between companies, it is important to think not only about how to develop relationships in the supply chain, with whom participants, and under which forms of contract, but also how to coordinate that relationships and which management control mechanisms and processes should be used to support, plan, measure and assess the activities and their results (Ramos, 2004).

One of these inter-organizational processes allowing the establishing and maintaining cooperation in the long term, is the exchange of information generated by the accounting system.

With the increasing integration of suppliers, manufacturers, contractors, it is reasonable to adjust the management accounting system in order to generate information that is useful in the formulation, implementation and execution of strategy aimed at achieving competitive advantage.

The information generated by management accounting are the primary source of data for decision-making and control. Proper management accounting techniques may have important implications for inter-organizational supply chain primarily due to:

- the provision of timely and accurate information to support and facilitate the decision-making throughout the organization and
- provide information on the effectiveness of its activities, as well as the performance of individual business units to ensure that activities are consistent with the plans.

Developing a long-term inter-organizational cooperation usually involves a complex process of negotiations. In addition, mechanisms and activities that play a role in supply chain relationships have to be controlled in some way. This also entails the specific information needs. Management accounting is seen as an appropriate set of techniques capable of providing this type of information.

Management Accounting Techniques for Supply Chain Management

In order to meet the requirements of supply chain cost management it is essential to engage a variety of management accounting techniques, especially the newest, currently being developed. These techniques are gaining popularity as means by which companies, including those operating in the supply chain, are able to meet the new challenges, gain competitive advantage and continually improve management systems. These new techniques are used in a wide range of businesses in response to changing economic trends.

It should be emphasized that the new management accounting techniques are considered to be new, not because they provide very different ways of calculation, but because they allow to look at the economic performance in the context of the supply chain. While the traditional management accounting is aimed at providing information on how profit can be maximized by rigid forms of control and accountability mechanisms, new techniques seek to determine how the value that is acceptable to all participants in the value chain can be maximized, and thus what level of performance can be achieved in the supply chain. The new management accounting techniques meet a number of requirements that are specific to supply chains. The most important are:

- ensuring effective cooperation between suppliers and customers,
- management of communication and negotiation among the participants in the supply chain,
- exploit the possibilities of continuous improvement,
- eliminating opportunistic behavior
- enabling continuous learning and coordination.

A common feature of modern techniques of management accounting is their strong focus on operations and processes and a horizontal look at the organization, what enable crossing the traditional boundaries of the company.

Although most popular are primarily two techniques of management accounting: Target Costing and Open Book Accounting, actually also other techniques can be useful in the process of supply chain cost management, for example the Activity Based Costing, Kaizen Costing, Theory of Constraints, Value Chain Analysis or the Balanced Scorecard.

Open Book Accounting is a technique involving the sharing of reliable accounting information among supply chain participants. This approach reflects the ideal collaboration between buyers and suppliers through the disclosure of cost information of individual companies.

Open Book Accounting enables the supply chain participants to obtain information about the structure of the production costs of other participants, assessing the effects of changes made by others, estimate the costs of new products, identify areas of significant cost savings and better control of production costs of finished products (Sobańska, 2010).

Target Costing provides the ability to control the level of costs and profits in the context of the opportunities arising from the competitive environment. It is a cost management technique that allows a look back at how the products should be designed in order to achieve the target cost. This procedure determines the required cost savings and enables the implementation of improvements in the supply chain.

Target Costing technique applied in the supply chain environment can be extended to inter-organizational co-ordination of the activities undertaken in the process of cost management (Ramos, 2004).

The use of Activity Based Costing (ABC) for the supply chain is becoming quite common and replaces the traditional method of cost allocation system with a more accurate cost assigning. ABC improves the allocation of overhead costs to activities, processes, products, services and customers. This costing system focuses on the activities and provides valuable information useful to coordinate the activities in the supply chain. It also allows the observation of causal relationships in the cost

structure. ABC allows the identification of additional services provided by suppliers like designing and development of products that increase the value of the final product and reduce internal costs, including control and service.

Kaizen Costing is a similar technique to Target Costing because of the assumption of cost reduction, with the exception that Kaizen Costing focuses on reducing costs in the production phase of the product life cycle. According to Cooper and Slagmulder (1999), Kaizen Costing is the basic technique of inter-organizational cost management in the phase of production process. Kaizen system allows buyer set specific cost-reduction objectives for its suppliers. Suppliers, in turn, use their own system of Kaizen Costing to identify which areas have the opportunity to reduce costs, and translating this information into price negotiations with their suppliers.

Theory of constraints allows companies to focus on managing constraints that slow down the rapid movement of products through the supply chain. This in turn can help the supply chain participants to optimize financial performance through the use of their potential and resources (Simatupang, et al., 2004).

Value chain analysis can be carried out by a single company taking into consideration external perspective, or jointly by buyers and suppliers in the supply chain.

This approach involves not only the cost of buyer but also the activities and costs of other companies in the value chain (for example suppliers and buyers) and recognizes the interdependence of these activities and costs (Dekker, 2003).

Balanced Scorecard is an approach that complements traditional financial measures of performance of the enterprise. Modifying the Balanced Scorecard as a performance measurement method can be used to develop a comprehensive method of measuring supply chain performance. An essential task is to link the balanced scorecard with the main objectives of supply chain management. The best results for cost management purposes gives the connection of Balanced Scorecard with other methods used to manage, for example, the combined use of the BSC and Activity Based Costing and Activity-Based Management.

The adoption of the perspective of supply chain for the Balanced Scorecard expands the internal perspective of Balanced Scorecard so that it includes both internal functions and effects resulting from the partnership and co-operation in the supply chain. From this perspective, a balanced scorecard combines integrated and non-integrated measures and allows the perception of the success of enterprise as resulting from the success of the whole supply chain (Brewer, Speh, 2000).

The concept of Balanced Scorecard distinguishes four perspectives: internal processes, customer satisfaction, financial performance, as well as ways of improvement, innovation and growth of companies. Linking these perspectives to the concept of supply chain management requires the selection of appropriate measures, which are not limited to a single organization, but take into account the processes resulting from inter-organizational relationships.

The concept of linkages between supply chain and the balanced scorecard allows to evaluate the ability of the supply chain to meet management objectives, which can be evaluated by measures, identified with the perspective of internal business processes.

Total Cost of Ownership (TCO) is a technique that analyzes the costs of acquisition and use of goods or services during their life cycle. TCO can be used not only to build and manage effective relationships between the participants in the supply chain, but also to identify potential opportunities for improvement and to promote co-ordination and learning between partners in the supply chain.

Most Total Cost of Ownership related literature investigates this tool from a buyer perspective and consequently does not study TCO from an inter-organizational perspective. However within the supply chain management, Total Cost of Ownership in particular is a significant tool, since it can be an effective way of tracking the hidden indirect costs associated with supplier transactions, especially given that purchasing divisions are considered to be strategically relevant.

Conclusion

The purpose of costing system is to rationalize processes of business management. Both the costs at the planning stage as well as being recorded provide a valuable information about the degree of improvement of performance in the management system of both business units as well as the entire supply chain.

In a changing environment, management accounting must follow the changing economic trends. For the purpose of supply chain management it is necessary to develop new methods of

management accounting, or modification of existing techniques. It is also important to look at the supply chain as a whole. Although it is often considered that only the large corporations introduce innovations, there are many smaller and medium-sized companies that are participants in the supply chain together with large of companies. The condition of their subsistence to a great extent is the ability to function in larger organizations, being a member of the supply chain.

Efficient supply chain cost management is possible by the use of appropriate methods and tools, which include new cost accounting systems that generate information on the level and structure of costs in the desired cross-section information.

In recent years, it can be observed a growing interest in the field of supply chain management accounting. The combination of operational and financial dimension can provide a competitive advantage and operational stability. Managerial accounting has therefore an important role to play in improving competitiveness by improving supply chain management processes.

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GLOBALISATION AND TRADE UNIONS CHALLENGES: NIGERIAN MANUFACTURING SECTOR EXPERIENCE

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Abstract:

Today, the globalisation of the world market has brought about several competitions on local companies which invariably have an adverse effect on trade union density due to unfavourable macro-economic policies used for the promulgation of globalisation. The movement from Social regulation to Labour Market Control, created this competitions all in the name of productivity enhancement and efficiency creation. The study examines the challenges brought by globalisation and all what accompany the concept while the role of Trade Unions was also measured to overcome the flexibility brought by globalisation. The study uses secondary information with discourse analysis of existing literatures on the subject matter to have a position. It was reveal that globalisation created more vacuums than integration among Workers of the North and South due to competition postulated by globalisation.

Key Words: Globalisation, Trade Unions, Manufacturing Sector, Flexibility and Competitions

Introduction

According to Aluko et al (2004) the concept of globalisation, its meaning, actors, processes and implications for developing world has received considerable attention of scholars and bodies in contemporary time. This is so, because globalisation has a negative effect on developing countries than the advance capitalist nations of Western Europe and North America with particular regards to their socio-economic progress.

Nigerian corporations operate in a rapidly changing environment characterised by global and national influences (Sagagi, 2007). Today, the globalisation of world market has brought about several competitions on local companies whereas the business atmosphere in the countries (developing) are increasingly becomes unfavourable due poor macro-economic management brought by globalisation and all what accompanies it.

This assertion was corroborated by Standing (1997) when he said the societies has been moving from social regulation control to Labour market control with an objective of enhancing productivity efficiency and creating competition among nations. Furthermore, it leads to wage flexibility and affect employment security as well as reduction in union membership density.

Globalisation drivers are Information and Communication technologies as well as socio-economic policies designed by Breton wood institutions to established labour market competition through internalisations of the world economy. However, external environment like IMF and World Bank are seen by Nigerian corporate leaders and Trade Unions as the major constraint to the development of manufacturing sectors.

The tendency to associate corporate problems with global and local factors lead to serious discontent among the management and trade unions with the manner in which government restructured the economy in line with free market ideologies (Sagagi, 2007). This explains why Nigeria Labour Congress and Manufacturer Association of Nigerian have increasingly voiced their dissatisfaction with the effort of government to liberalise the economy without providing the necessary impetus for local industries to flourish before thinking of going globally.

No wonder Standing (1997) mentioned that creating full employment through labour market policies by expanding demand for workers through attraction and retention of capital will make globalisation work. This is so, because one of the major purposes of labour market regulation is to

protect various groups against insecurity, oppression and exploitation but in Nigeria reverse is the case. Due to this concomitant of economic reforms under globalisation are pain-inflicting, whereby workers and civil society organisations were impelled to respond to them with strike and protest in the country.

It's on this basis that this study is geared towards probing the challenges brought by globalisation to labour movements across world with special focus to developing countries like Nigeria where the concept (globalisation) has been misused in the name of global village for countries survival. The study examines the concept of globalisation as was defined by different scholars, measured its relevance to manufacturing sector of Nigeria economy vis-a-viz with other macroeconomic policies that was used for its promulgation as well as identified the major roles played by Nigeria Trade Unions to avert the spreading of the globalisation gospel while substantive conclusion and recommendations was postulated in the study.

Globalisation: The Contending Viewpoints

The concept of globalisation has been variously defined by different authors with different perspective depending on benefits or otherwise of the concept. Some sees globalisation to have come to stay, therefore nations must strive to swim along with the trend while some were of the opinion that globalisation is all about exploitation that need to be discarded. Scholars like Frege and Kelly (2003) belong to the first school of thought, that what trade union need now is to revitalise in order to remain relevant in the new trend of internationalisation.

Baylis and Smith (1997) defined globalisation as “the process of increasing interconnection between societies such that events in one part of the world have more effects on peoples and societies faraway”. They added that globalised world is one in which political, economic, cultural and social events become more and more interconnected with more impact. This definition was in line with the reason adduced by standing (1997) when he said globalisation is beyond geographical location whereby competition will emerged as a result of many nations participation. Therefore, there will be flexibility in mode of operation of every country that adopts globalisation and this will lead to erosion of rights and security in employment.

He emphasized that the changes from social regulation to market regulation will affect likely all part of labour market structure from employment security to representation security and dismantling labour regulatory system. And this will change international division of labour and increase unemployment or push for flexible labour market arrangement whereby trade union power will be weaken.

Sagagi (2007) said globalisation has helped some countries grow faster than they would, if they had otherwise localised their strategies. At the same time, it blamed for widening the gap between poor countries which are mostly located in Africa, and those of the industrialised nations. Thus, it is paramount for corporate leader, policy maker and trade unions to pay greater attention to the involvement of Nigeria nation in the global economy participation when the country lacks resource to compete at this level.

Nigeria has adopted a trade liberalisation policy since 1986 in order to benefit from the fast integrating world economy (Sagagi, 2007). Unfortunately, its manufacturing industries continue to face rather difficult competitive challenges from foreign rivals because the citizens were dumping the locally made product for imported ones and these threatening their very survival. Abdullahi (2004) argues that Investment opportunities exist in the Nigerian manufacturing sectors considering the vast array of agricultural and mineral resources available in the country.

But the Central Bank of Nigeria (2004) reveals that Nigerian manufacturing operate under the environment characterised by aggregate demand, high cost of production, deficit infrastructure facilities, low investments, poor electricity supply and decreasing bank lending. This resulted in the capacity utilisation of the manufacturing sector, which lead to reduction in employment or layoff of personnel sometimes.

This corroborate Webster, Lambert and Bezuidenhout (2008) assertion that for globalisation to work there must be a stable political structure cum effective infrastructure development rather employers we embark on despotic ruling instead of hegemonic rule setting with consequence of threatening workers with relocation of plant. Also, it will lead to top-down management style where target are set without consultation and increases irregular workers (causalisation) while work intensification will be the order to the day.

Webster et al (2008) maintained that globalisation lead to manufacturing of insecurity whereby creating flexible worlds of work due to openness of the economy up to competition and deepen their integration into world economy. Therefore, the issue is how best can nation like Nigeria take the advantage of the opportunities presented by the growth and growing openness of the world economy and how best countries can live with the unavoidable difficult that globalisation may bring by modifying the system to make it operate better.

However, in order to reap the benefits of globalisation policy makers especially in Africa have to embark on sound and stable macroeconomic policies, better governance, legal and financial reforms and infrastructural investment. Also, effective social spending is important in the globalising world economy. This is so, because globalisation delivers its economic benefits in part by promoting changes in the rise and fall of different industries and economic activities.

Globalisation and Manufacturing Sector challenges

One of the greatest problems facing the Nigerian economy is the problem of capacity utilisation in the manufacturing sector which was caused by globalisation. The problem became more pronounced and aggravated by the Structural Adjustment Programme (SAP) and more recently by globalisation and all that accompanied it like Privatisation, commercialisation, Trade liberalisation, Deregulation of the downstream economy sector to mention few.

All these are agenda of globalisation been champion by it agent like IMF/World Bank in the name of creating borderless nations or internalisation of the World economy. These make must sector of Nigerian economy to be unattractive. The manufacturing sector is on the verge of collapse with thousands of workers being thrown out of jobs while those that remaining in the working environment is not adequately taken care.

This corroborates standing (1997) position on organisational impact of globalisation that it resulted to decline in membership and lead to trade union density reduction. This is so, because globalisation brought about cost of production reduction on the part of capitalist whereby workers are rightsizing and downsizing all in the name of competition while this lead to layoff or retrenchment and affect union membership.

Again, Aluko et al (2004) mentioned that Nigerian had become a dumping ground for all kinds of foreign products. They attributed this to globalisation and all that accompanies it because Nigeria local industries cannot compete favourably with their foreign counterpart therefore lead to production of substandard product while the customers dump this for foreign products and makes importation to be at alarming rate at the expense of local production.

Therefore, there is need to turn the search light on globalisation and examine its impact on Nigeria economy particularly the manufacturing sector where there is quantum number of employees. This is with a view to examine whether it is beneficial or not and suggest how Nigeria interest can be protected under the global agenda or arrangement if Nigeria must continue to participate in globalisation race.

Aina (1996) concluded that globalisation is still about exploitation, accumulation, inequity and polarisation in world politics. He maintained that globalisation consolidate the existing international division of labour which confines Africa to a role of supplier of raw materials and commodities and consumer of manufactured goods from developed countries. This is in line with Webster et al (2008) findings, when they mentioned that globalisation created division between North and South which eventually diminished resources in southern region especially union resources because of the gap between the regions.

Globalisation also involves widening and intensification of links between the economies of industrial and developing countries through trade, finance, investment, technology and migration. The recent advances in globalisation are therefore predicated on the notion of interdependence between the internal and external sectors of an economy (Sagagi, 2007).

Nigerian manufacturing sector was characterised by low capacity utilisation; low and declining contribution to national output; declining and negative real growth rate; dominance of light assembly plant of consumer goods manufacture to mention few. All these are the resultant effect of globalisation on developing country like Nigeria.

Furthermore, the deplorable condition of the manufacturing sector was due to large factors, principal amongst are: lack of an enabling environment; poor and inadequate infrastructure; poor implementation of incentive to manufacturers; policy errors of the past; low access to investible

funds; prevalence of obsolete technology; inadequate domestic demand and inefficient institutional framework (Aluko et al, 2004).

Nigerian Trade Unions and Globalisation

According to Girigiri (2009) he said Nigeria's involvement in the globalisation process is dated back to the period between 1986 and 2006 under the military regime of General Ibrahim Babangida (1986-1993) and the period under civilian regime of President Olusegun Obasanjo (May, 1999 to 2006). He said these periods have witnessed concerted efforts by government to implement economic programmes prescribed by International Monetary Fund and World Bank, two agents of globalisation.

The effect of globalisation was first noticeable between the months of May, 1992 and March, 1993 when there was chaos and total paralysis of Nigerian economy by labour due to the effect of Structural Adjustment Programme on workers been retrenched because of privatisation exercise. With the privatisation of the ports, no fewer than 300,000 workers would have to lose their jobs by the time the exercise is over (Nigeria Dailies, 2006).

At the privatisation of Apapa Ports recently, Association of Nigeria Custom Agents (ANLCA), estimated that no less than 10,000 of its members may be laid off. Even in the Federal civil service, government is still going on with its retrenchment of 74,000 workers, all in the name of restructuring the sector. These corroborate some existing findings which reveal that globalisation lead to decline in Unions membership due to workers been layoff or retrenched.

Another major challenges that globalisation prompted on Nigeria Trade unions is the Market Despotic ruling pointed by Webster et al (2008). In Nigeria, government has incessant increase the price of petroleum products without consultation with labour and the resultant effect of this is the hike in the price of other consumable goods which ultimately affect the standard of living of a majority of the populace who are workers. It is therefore, not surprising that the deregulation of the downstream sector has resulted to a running battle between labour and the state because of the adverse effect on the nation economy.

Furthermore, many organisations are tempted to design methods that solely meet technological demands because of globalisation. Organisation structures are designed to cope with the requirements of the fast pace of technological innovation without considering the human elements or activities of a number of individuals to achieve specific goals. Meaning that labour are just been treated like a commodities (Webster et al, 2008). This has inevitably lowered workers morale, most especially the bargaining power of manual workers and precipitate social problems both nationally and industrially.

Also, Nigeria trade unions have been accusing the transnational corporations of unethical labour practices as a result of globalisation which really affect their right of representation, particularly workers rights'. Practices like engaging under-age workers in factories, paying peanuts whilst extracting inhumane hours, providing poor work environment and general work condition that would have been penalised in their home countries. All this became a challenge to trade union because the set of workers are short-term contractor that are hardly to organise and their representation rights is damp.

Conclusion and Recommendations

The impact of globalisation on domestic firms in Nigeria has been overwhelming, disastrous and killing. Nigeria and firms both manufacturing and other sectors were not prepared for the challenges of globalisation. It was a double tragedy of unimaginable proportions as the manufacturing firms had to face both domestic recession and market exposure simultaneously (Aluko, et al, 2004).

The manufacturing firms felt the brunt of globalisation most, as many of them has to fold up while those in the business are down-sizing and operating below their installed capacities and the resultant effect is on the workers. The central challenge in the globalising world is for a nation like Nigeria to make its firms competitive. Indeed, the task of making the firms or companies competitive is a shared responsibility between the tripartite.

There is the need for Government protection through good and effective regulations aiming to achieve the goal of globalisation agenda whereby advantage emanated from government protection can be used by companies to improved competitiveness stemming from increased productivity and distinctive products. Also, companies should be flexible, adaptable, creative and capable of uniquely

learning from what makes Asian companies particularly successful in delivering greater value and actively involved in capacity building and knowledge sharing.

However, trade union should be more to revitalisation strategies as Frege and Kelly (2003) have rightly put. Although Nigeria trade unions have developed series of revitalisation strategies ranging from Organising strategies to International linkages but noticeably among them is the Political alliances and coalition building.

In the year 2003, under the leadership of Nigeria Labour Congress President Adams Oshimole there was a strong coalition between the Nigeria Labour Congress and the civil societies to oppose price increases in petroleum products which lead to strike action that paralysed the nation's social and economic activities, forcing the government to negotiate with them.

Another area need mentioning in Nigeria trade union revitalisation strategies is the alliance with political parties. Nigeria trade unions has been working with some political parties that has the same ideologies with them in order to lobby government in power over favourable labour legislations, even to an extent of having political party that presently ruling in the country.

In the year 2004, the Nigeria president sent a bill to the nation assembly over the powerful nature of the central labour organisation (NLC), the trade union used their political alliance with parties to lobby the House of Representatives members so that the bill will pass in their favour and lead to Trade union Act of 2004.

Meanwhile, international link with foreign trade unions is important to mention particularly influencing the Multinational corporations from their home countries over unlawful labour practices in the country such as employing under-ages and kicking against contract workers. This is done through solidarity because Nigeria central labour organisation is a member of International Trade Union Congress (ITUC) and challenge consistent with interdependent actions needed to bridge the North-South division to place globalisation at the service of justice and prosperity for all nations.

By and large, trade unions partnership with employers in Nigeria context is not common because of the divergent interest of both parties unlike Germany where the gospel is about codetermination. However, organising strategies and Union restructuring is a new trend in Nigeria against globalisation by trade unions. Here, the young viable and committed workers were been cohort into the main stream of the union by giving an elective positions to make them get acquitted with how union struggle is been carried out. Also, women folks have been encouraging to join union in order to create gender balances and not seeing trade union job as men's job. All these are the revitalisation strategies adopted by Nigeria trade unions in order to overcome the challenges posed by globalisation, especially workers' rights.

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NEED FOR DEVELOPING HUMAN CAPITAL MANAGEMENT IN SMEs

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Abstract:

This research work is a documentary that exposes the importance of training and human capital development in SMEs, particularly the manager, for the decisions they make and carry the same significance in both the external and internal environment of the company. It mentions the need to investigate the effect of training and human capital development manager in the growth and survival of SMEs.

Keywords: Human capital management, training and development, SMEs

Introduction

For three decades, have been intensifying a series of economic, technological and social where Mexican firms are embedded, the response being competitive for companies that are concerned about adapting to this environment, and also stay current and grow. The term competitiveness is no longer a static concept focused on purely economic aspects. Currently, incorporates various factors like culture, social development, health, environmental sustainability, tourism, education, politics, quality of human resources, their spatial location, among others.

Companies manage to be competitive through its human capital, with large companies who generally recognize it as an important strategic factor that must be present in their planning. Today, small and medium enterprises (SMEs) are realizing the need of having in their template specialized people, with the skills to develop innovative solutions that give them competitive advantages and bring down their low survival rate.

Characteristics of SMEs

Much has been reported in several studies, the problem of lack of competitiveness that afflicts SMEs, as are those that generally have a low survival rate (Esparza, Monroy and Granados, 2012; Lecuona, 2009). In Mexico, 99.8 percent are micro, small and medium enterprises, however, this count is the total economic units in the country and does not identify those with the competitiveness problem, or that seek to attend (Fund SME 2012). But it has been estimated that the total SMEs that open their doors each year, only 17.5% can survive two years later (Pavon, 2010), ie, the rest closed before that time, which shows poor performance or competitiveness.

Under that MSMEs generate 75.1% of employment (ME Performance Report 2007-2011), is highly relevant to support them through some instruments such as SME Fund consisting of economic resources that the federal government grants through the Ministry of Economy (ME). The SPO of the SME Fund 2012 are linked to the Public Policy Hub 2 of the NDP (National Development Plan), "Competitive economy and job generator" as well as the Axis Rector 1 of the SEP (Sectoral Economics Program), "Detonate the development of micro, small and medium enterprises", in particular with the Rector Objective 1.1 "To contribute to job creation by promoting the creation of new companies and the consolidation of existing MSMEs".

Now, in terms of productivity, micro enterprises contribute very little to GDP, however small and medium enterprises account for 4.3% of the total land and generate 29.4% of employment, are highly productive and are the backbone national economic activity being the main providers of large companies. (ME, Performance Report 2007-2011). Atkinson (1984) According to the statement of the

Ministry of Economy (ME) on June 30, 2009. The following table presents (No.1) shows how companies are classified in Mexico.

Table.1 Classification of companies in Mexico

SECTOR	MICRO ENTERPRISE			SMALL BUSINESS			MEDIUM		
	Staff	Annual sales range (mp)	T.M.C*	Staff	Annual sales range (mp)	TMC *	Staff	Annual sales range (mp)	TMC *
Industry	0-10	Up to \$ 4	4.6	11-50	From \$ 4.01 to \$ 100	95	51-250	From \$ 100.1 to \$ 250	250
Trade	0-10	Up to \$ 4	4.6	11-30	From \$ 4.01 to \$ 100	93	31-100	From \$ 100.1 to \$ 250	235
Service	0-10	Up to \$ 4	4.6	11-50	From \$ 4.01 to \$ 100	95	51-100	From \$ 100.1 to \$ 250	235

Source: Official Journal of the Federation 30 June 2009

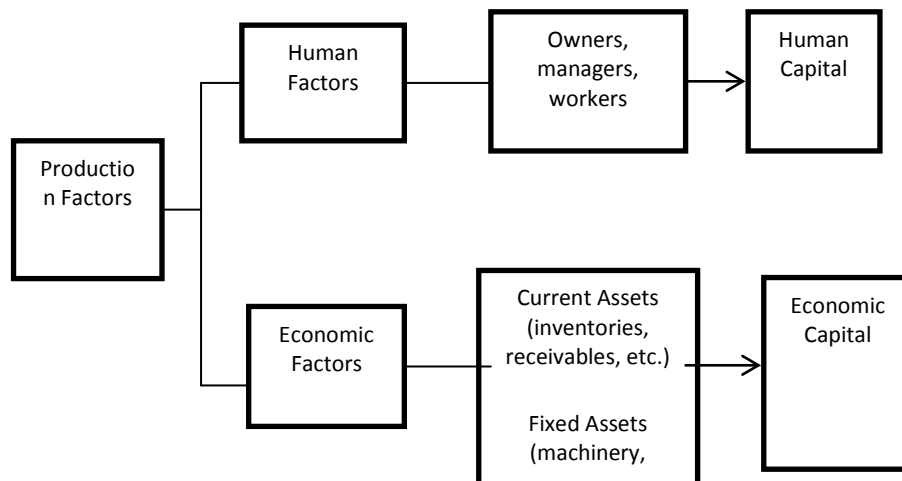
* TMC (The maximum combined) = Workers) x 10% + (Annual Sales) x 90.
(Mp) = million pesos

Pavón (2010) in his study said that SMEs in terms of the quality of human capital employed, according to figures from INEGI and ME in 2003, only slightly more than half of them provided training to their employees, most of staff plant, and to a lesser extent to the owners and partners. This is striking considering that SMEs are considered to be more easily adapted to different macroeconomic scenarios, given its structure and functionality (Pavon, 2010), however, given the changes in their environment rapidly in last thirty years, impacting them so that it is no longer possible to direct them under the same old model, prior knowledge and experience, so that managers warn their great responsibility to be alert to changes, opportunities and threats on their companies. Small and medium enterprises (SMEs) should be prepared to face all the economic, technological and social changes taking place today, because their competition surely will be prepared. Atkinson (1984) believes that companies have warned that human capital is a key to its development. In this era of knowledge and information, SMEs are realizing the need to have on staff, skilled people with the skills to develop innovative solutions that give them competitive advantages and bring down their low rate survival.

Human capital in SMEs

The company defined as an economic entity pursuing certain objectives (in the case of a lucrative company would be the generation of profits) through the production of goods and / or services and the marketing thereof. Being required elements known as factors of production for such activities (Figure # 1)

Figure # 1 Factors of production



Source: Own elaboration based on Martin, et.al, 2004

Of these elements, we have considered the human factor as a key to achieving the objectives of the company such as indicated by Romero and Muñoz (2006), cited by Teran, et. al (2008), companies need people with specialized skills to develop innovative solutions that give competitive advantages to organizations in which they work and to help them improve their productivity and redesign of business processes by taking advantage of opportunities that provide process technologies, products and information.

They are the people (human capital) who should know better use of management (efficient) the financial resources available to the company to achieve its goals. It is clear that every person within the organizational structure has different scope or power of decision, but each from his trench must be competitive. A competitive person is one who is known for being innovative, creative, proactive, motivated, highly skilled, flexible, available, have complex thinking among other features.

Put in another way, the factor or human capital is the key to competitiveness in companies, but in SMEs, particularly small, a weakness is to consider that only the owner is the one who can perform efficient resource management and has failed to surround himself with people who are talented in the areas that make up the business and support, companies that depend on one man at some point fail. Another aspect that has been neglected, is, less has been concerned is, realizes that he just cannot do all the work, because it would fail. The owner requires its staff to learn and know the company, put aside the fear that takes away power and authority, on the contrary, the entrepreneur manager who is a good leader, intelligent, always look to surround himself with the best, since he knows that by the quality of its people depend on the growth of the company (Lechuga, 2004)

In modern times, this is essential because as indicated Dessler (2001) "Trends such as globalization and technological innovations are changing the way companies manage," says that the traditional pyramid structure is flattening, today more powers are delegated employees to make more decisions, more work is organized around teams and processes, changing power bases and now managers must establish more commitments. Dessler (2001) adds that these changes mean that organizations must rely more heavily on a committed staff and self-discipline.

Sáez, et.al. (2003) note that changes in work organization require all employees to acquire new skills, referring to management personnel including: oral and written communication, teamwork, interpersonal sensitivity, leadership, management planning, reasoning analytical, problem-solving ability, decision making, creativity, entrepreneurship, dynamism, energy and initiative and stress management.

The question that entrepreneurs make is where to get that human capital, as it is not as economic capital that is available in any market or business. Or, how you can change and help the current human capital that the company has to be competitive.

Training and development of human capital

Human capital theory is developed in the mid-twentieth century, where Mirce, Schultz and Becker are outstanding exponents of the same theory, which believes that the talent of the people,

expressed by their knowledge and skills, rather than being something innate, is acquired and develops through learning and experience, providing formal and informal education (school, work, home). But this capital is perishable, meaning it's lost because of the obsolescence of knowledge and skills, from oblivion by the lack of practice, or the deterioration of the health of the person.

Padilla and Juarez (2006) suggest that human capital consists primarily of knowledge and skills acquired through formal and informal education in the education system and in the home and also through the training, experience and mobility of the labor force. Thus, educational institutions and businesses are pillars of training and human capital development, namely academic life and working life should be linked to equip people with knowledge, skills and experience which will cope with the changing circumstances of the work environment in which they are pursued. One of the ways it is conducting this linkage is through internships, where students being in real scenarios, to gain experience, to perform tasks of their profession, to complement their academic preparation, acquire specific skills and get his security upon graduation, that they will have an excellent performance of his duties as a professional for the benefit of society (Hernandez, et.al., 2010).

In business, human capital lies on its staff, is the acquired knowledge, the skills they have, the ability and willingness to learn, placed at the service of the company where they work. An example of this is the personal satisfaction, skills and attitudes of individuals, leadership skills and teamwork (Navas and Ortiz, 2002).

Madrigal (2009) notes that the human capital of the company is a source of development and therefore one of the factors that generate competitiveness. It is then that a competitive business is one that incorporates or train competitive people and continues to improvement. Everyone has skills, but not all apply those capabilities. In training and human capital development must always go together these two main elements, learning and experience. Sometimes companies taught numerous staff courses, provides a wealth of information and thinking that will form and develop human capital, but learning is not applied is useless, not useful, forgets and causes the discouraged worker trained go or simply refuses to receive it because it does not see the benefit of it. Just as there are many empirical people, they do things, but always in the same way, and when it comes to innovation and changes, are the most resistant because they do not care to learn that there are different ways to perform activities and perhaps with less effort. So then learning is complemented by the experience and vice versa.

"Knowledge, if it not applies, only provides the intellectual satisfaction of those who practice them, while willing to do without knowledge and without know-how, have important limitations, since knowledge is the substrate helps improve and advance to overcome difficulties. Knowledge facilitates decision-making and expertise helps solve." (Saez, Garcia, Palao and Rojo, 2003).

Problem statement

Small businesses of the industrial sector is 11 to 50 people, with about 80% of the workforce operational and the rest in management, according to the Ministry of Economy, basically for a small business management positions to its main functional areas would be the manager or owner, production management, sales management, administration and finance management and quality control management.

Usually in small businesses, management positions are assigned to the owner family, just for the fact of being part of the family given the distinction of being the head of the company (Ceron, Pimentel and Barranco, 2007) and not only to have a strong background or experience, which leads to companies that have been in management positions to persons lacking knowledge and experience to be good leaders, only wield power and authority. Or, there are cases where owners are worried about leaving the reins of the business to the children who have professional education, but lacking experience and love for the business makes to not get involved. There are also cases where very young owners joined their children in the business and gained experience, falling on them more and more responsibility to the extent that the work completely absorbed and do not have time to prepare academically. This evidence then that in small businesses can be found without knowledge leaders and inexperienced leaders, with experience and knowledge but without knowledge and leadership experience. But ideally is to have leaders with knowledge and experience.

SMEs in the country faces the problem of lack of effective management and cutting edge derived from the lack of development of their managers that retain traditional knowledge and obsolete, which entails that these companies cannot face the complex world competition in which they are immersed.

No matter the size of the company, it is important that their managers to appropriate administrative and management knowledge to inform their decisions which impact not only within the company as productivity, profitability, but also outside the create jobs, to worry about the environment, and the development of the country.

As for SMEs, studies concerning the lack of competitiveness show that although care has been taken to support them with funding, technology, with tax, it will not be enough to produce the changes they demand the current environment if they neglect their human capital (managers and workers), since from them depend the value creation of the company.

The development of human capital in small businesses has been limited to operating personnel to provide training and job training (Lopez and Luna, 2009), is aimed at learning is how to perform and how to improve production, but neglected the manager because no having programs that meet their requirements, and properly is the person who tries to stay current (Gonzalez, et al, 2012) may be due to misconceptions that managers in the position they occupy within the organization know everything and can do everything. One reality is that managers should also be trained and developed to understand and thereby directing the subordinate. Lopez (2005) comment that it is difficult to find talented people, not because of the lack of knowledge, but the problem lies with the leaders of the companies that keep highlighting the abilities and efforts of its staff just to maintain control. Human capital development aims to expand, develop and improve the individual for their professional growth in his career in the company, or to promote efficiency and productivity in office (Sáez, et.al., 2003). Thus the development of human capital raises long-term goals preparing the individual to take responsibility and more complex actions of the hand which requires the current environment.

This raises several questions as to know what percentage of small firms have training programs and development of its human capital management, and what effect it has had on the company's training and development of human capital management.

Goal

Identify small businesses with training and development of human capital management.

Justification

Although SMEs in Mexico are generating 75.1% of formal employment in the country, fail to provide a permanent job, much less guarantee growth in personal and professional development of employees, due to the short life span as they have, due to their lack of competitiveness.

Speaking of competitiveness is a complex problem, different theories analyze this phenomenon and give explanations about its cause and propose solutions on how organizations can create competitive advantages that allow them to adapt to circumstances and environmental turbulence and stay longer times.

Among these contributions is the human capital approach, based on the wealth that every organization has in both operational and management staff, operatives are those who strive to get quality products or services and managers in making decisions channeled towards achieving objectives. This wealth deposited in operational staff and management of the company, cannot be stored but must be developed and be effective in achieving the objectives of the company.

Small businesses have been characterized by neglect this aspect of training and development of human capital mainly to managers, as operational staff are taking training courses, but do so rather to satisfy legal requirements or labor (Gonzalez et . al., 2012), rather than to be convinced of the benefits in the investment in human capital.

Therefore, it is appropriate to conduct studies that show how is composed the human capital management in small business, their training, their experience, their functions, their responsibility, their seniority, the power they wield, the index rotation at this level, and so on., because this will show needs that require training and the impact that will generate growth and continuity of the company.

There are no detailed studies analyzing human capital management and its effect on the survival of SMEs, their productivity, profitability, and competitiveness. When making studies of human capital management and correlation with growth, survival, etc., conclusions can be drawn to guide the economic, financial and educational links with SMEs.

Conclusion

SMEs in Mexico are concerned about the issue of the formation and development of its human capital, but mainly with operating personnel to meet brand aspects that federal labor law, but human capital management is neglected, unlike large companies that spend a significant investment in it.

This work shows the importance for companies and their directors and realizes the little research that has been done regarding the effect of prepared managers in the growth and survival of SMEs.

To the extent that there are more companies that address the need to train and develop their human capital, and provide information about it will be in ability to generate quantitative data including reports of non-financial nature, by identifying the benefits generated training and development human capital to the organization where he works.

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CHALLENGES AND RELEVANCE OF ECONOMICS AS QUEEN OF SOCIAL SCIENCES IN PRESENT SCENARIO

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Abstract:

In the paper an attempt has been made to respond to the question that the teachers and the researchers in economics are to do what? why? when? where? for Whom with Altruism? Further issues have been identified for deliberation and discussion on relevance and education of economics for the other disciplines in social sciences.

Being humble students, teachers and researchers in economics, we believe that there are gaps in the learning, teaching and research in the subject which is otherwise important for one and all as consumers, producers, distributors and traders. Unfortunately, it is the economics of education which has devalued the value of education. We need to strengthen the educational value of education instead of devaluing it by attaching economic value to it. There is trade off between teaching and research in economics. Most of the teachers in schools and colleges are not able to do research of any kind in the subject of economics for want of time whereas most of the teachers in universities and research institutions devote more time to research obviously to get promotions which are based on research contributions and not the quality of teaching. The number of students in economics in schools, colleges and universities are declining probably because of the fear of mathematics which must be used to understand economics and not to complicate the subject as observed by Paul Ormirod in his book ' Death of Economics.' The use of software SPSS (Statistical Package for the Social Sciences) is necessary but not sufficient in social science research. To make it sufficient, there is a strong case for proper analysis to draw policy implications which are otherwise missing. The use of SPSS is capable of re-establishing economics as a queen of social sciences as called by Noble Laureate Paul Samuelson. There is a strong case for higher allocation of funds for social science research in India.

Key Words: Consumers, producers, distributors, traders, knowledge-economy, needonomics

Introduction

All of us know that social science is all about the study of people and the factors affecting them. To know, why is economics considered the queen of all Social Sciences? Why not the other branches of Social Science? To my mind, the best reply is that economics explains a lot of the social phenomena of the world and plays a major role in each of the other branches (i.e. in sociology: haves vs. have nots, crime, what's going on in society; in political science: why countries do what they do, international trade, even war; in psychology: a person's mindset is affected by their socio-economic status; etc).

According to Samuelson, economics is the queen of social sciences. It is true that economics was the queen of the social sciences when it consisted of brilliant men revealing surprising truths about the nature of societal interaction. Presently, we have to accept that we adopt trial-and-error policy experiments in India, and calling it academic research which brings bad name to the subject.

As economics has lost academic market share, it has also faced, like other declining industries, escalating complaints about the quality of its product--its core theory and how it is taught. The problems appear to be, in economists' terms, both a deterioration of human capital and a technology increasingly mismatched to its labor force and customer demands. As economists, we are in danger of failing to become even what Keynes thought the best we could hope for, the "dentists" of social science--competent technicians in a distant but better world.

Challenges

Being a humble student, teacher and researcher in economics, I believe that there are gaps in the learning, teaching and research in the subject which is otherwise important for one and all as consumers, producers, distributors and traders. Unfortunately, it is the economics of education which has devalued the value of education. We need to strength the educational value of education instead of devaluing it by attaching economic value to it. There is trade off between teaching and research in economics. Most of the teachers in schools and colleges are not able to do research of any kind in the subject of economics for want of time whereas most of the teachers in universities and research institutions devote more time to research obviously to get promotions which are based on research contributions and not the quality of teaching. There is a strong case to reconsider the existing form of teacher-student relationship and evolve a system of education based on an interactive approach. We need to emphasize upon the role of the teaching fraternity in devising methods for holistic development of students.

I saw the movie '3 Idiots' with curiosity along with my family of teachers. The comedy of its own kind wrongly named and deserved a pat on the back to be named as '3 Genius' of the present era. It is full of message and lessons for all the stake holders of education system in all times to come which calls for drastic changes in the interest of the sustainable human development of Indian economy. 'All the best' is motivating for the self and the others. The Jugad technology of Indian origin deserved a patent to be recognized with international standards as survival of the weak but unique relevant in times of crisis.

Relevance

Economics is the mother science of all the subjects including commerce and management which are in demand today. Even to become politician in power or opposition with any political party in India and else where in the World knowledge of economics is a must.

The contemporary developments in the world economy and consequent policy ethos have only added to the felt-need for trained/professional economists ready to take on the challenges of a globalized 'knowledge-economy'.

We may like it or not, there is no escape from the reality of goods and services. As long as these goods are to be produced and distributed with reference to the claims made in the present, without losing sight of the future, some kind of 'rationality' would be called for, and hence the need for Economics as a discipline. More so, when we are living in a world full of contrasts- plenty co-existing with dehumanizing poverty, one often asks the following set of questions:

- Who is to do What?, Why? When? Where? for Whom with Altruism?
- Why we are where we are and others in a different position?
- Can goods and services be different for us?
- What can we learn from the experiences of others as consumers, producers, distributors and traders?
- Can we tap the accumulated knowledge for alleviating poverty of one and all?
- Can we ensure good governance for inclusive growth?
- What are the options, instruments, and institutions available to us?

Additionally, the leaders in all walks of life also require, and play with, strategies to stay at the top. For some it is a question of initiating change and bridging the gap, for others it is the management and sustainability of economic growth that is more important. Both sets are faced with economic questions and seek authentic answers.

These types of questions are equally relevant for the individual (micro) as also groups— Self-Help Groups. Each agent/agency can take its own decisions out of convention, tradition, habit, gut-feeling and the like, often availability of professional advice is considered necessary and desirable. A need for trained (professional) economists springs from this source. A professional, besides having a strong spirit of enquiry, is required to be well-versed in a variety of skills to handle a situation. But, that presumes an ability to comprehend the situation and think of alternatives, relate those to the past and come up with policy measures for the future. This calls for development of certain skills which is, by and large, not possible under the existing arrangement. In addition, the gap between theory and practice needs to be bridged through on- the- job training. The influx of foreign universities is partly due to the growing market for trained professionals. The indigenous systems need an urgent up-gradation for negotiating this neo-imperialism. Quality product at affordable prices is the answer.

There is certainly a case for making the present courses of study relevant for catering to the new/emerging demands on the profession and challenges faced by a 'resurging India'.

Economics is about choice; taking decisions in one's best interests given the constraints imposed by income, costs and time. It analyses how people, firms and governments obtain money and how their spending influence the production and distribution of goods and services. It emphasizes people's activities as they use their environment to produce goods and services and distribute them. Economists study how a society distributes scarce resources, such as land, labour, raw materials, and machinery, to produce goods and services. They conduct research, collect and analyze data, monitor economic trends, and develop forecasts. They research issues such as energy costs, inflation, interest rates, exchange rates, business cycles, taxes or employment levels. Economists devise methods and procedures for obtaining the data. For example, sampling techniques may be used to conduct a survey and mathematical modeling techniques may be used to develop forecasts. Preparing reports, including tables and charts, on research results is an important part of an economist's job. The various specialization in economics are : Agricultural Economics, Financial Economics, Labour Economics, Industrial Economics, International Economics, Econometrics, Development Economics, Economics of Human Resource Development, Health Economics, Rural Economics and Business Economics. We only need to learn to understand, analyze and interpret the economics of any thing and everything on earth including cost of a missed call which is not zero as is generally told by many students of economics who should know the difference between fixed cost and the variable cost.

To serve the society (All minus Myself) with altruism and without traveler's dilemma, let God provide us tons of opportunities to prove our worth and potential as students and academics in economics for all times to come.

May our soul become compassionate to learn that it is beneficial to save even one soul from Mahamaya's prison (Greedonomics) and prisoner's dilemma. This calls for promoting Needonomics as a subject of relevance which is capable of removing the FEAR (False Evidence Appearing Real) of the so called global economic crisis very well diagnosed by US President Obama as a consequence of greed and irresponsible behavior of some. To maximize growth in the present times of global economic crisis, there is an urgent need of re-writing the theory of finance for which young economists are to be motivated to do serious research. We need to understand the multiplier effects of the share market in various sector of the economy.

To create a climate of investment and growth in the Indian economy, we need to make every possible effort for increasing the marginal propensity to save which requires correct valuations of shares by reducing the risks over time and space further required for increasing the returns.

It may be relevant to read the writings of J.M. Keynes that 100 percent freedom and deregulation for the finance market is not conducive to predictability of steady growth of the markets of the economy. Contrary to this observation, the NPA in the Indian Banks probably is the result of the State intervention and need to be discouraged. We need to do soul searching for concrete plan of action to re-establish economics as a queen of social sciences.

Conclusion

Economics is a necessary subject for everyone as consumer, producer, distributor and trader to learn and comprehend. It is really a queen of social sciences as conceptualized by Noble Laureate Paul Samuelson but has reduced its stature because of the human behaviour on which it is based. The present economic crisis compelled us to believe that economics is not sufficient to solve all the problems of the people. To make economics sufficient, we have to look around our epics, particularly the *Bhagavad Gita*, which is an 'ism-neutral', 'religion-free' treatise on management and welfare economics. We should avoid plagiarism (the intellectual theft) in our research endeavors which is a moral and ethical offence rather than a legal one. Data on socio-economic indicators with all its limitations are essentially required for doing research in social sciences which are useful for making projections for perspective development planning and can be viewed as the integral part of health planning, educational planning, environmental planning, population Planning, employment planning, social and regional planning. To minimize the data limitations for social science research in India, there is a strong case for minimizing the time lag between the collection and publication of data, consistency in the concepts and definitions of important data, coordination between different data agencies and Strengthen the data base for future prediction to be more certain.

The use of software SPSS (Statistical Package for the Social Sciences) is necessary but not sufficient in social science research. To make it sufficient, there is a strong case for proper analysis to draw policy implications which are otherwise missing. The use of SPSS is capable of re-establishing economics as a queen of social sciences. There is a strong case for higher allocation of funds for social science research in India.

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CAPITAL STRUCTURE: EARNING AND THE PERFORMANCE OPTIONS IN SMALL AND MEDIUM SCALES ENTERPRISES

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Abstract:

The study examined the relationship that exist between the capital structure mix of the SMEs and the overall performance of the firm over the year s, poor combination of debt-equity finance has been the bane of small and medium scale enterprises (SMEs) in Nigerian. The study made use of questionnaire a survey method for data collection and chi-square a non-parametric method for data analysis. The study revealed that most SMEs have an all equity finance structure and has a less debt finance to equity finance. It also revealed that the earning, survival and growth of the SMEs is strongly influence by the capital structure mix.It was recommended that the government should design a homegrown and SMEs friendly debt financing structure and managers of SMES should also seek professional advice when approaching financial institutions for debt finance.

Key Words: SMEs, Earning, Capital Structure, Debt, Equity

Introduction

Today it is not a gainsaying that the Small and Medium Scale Enterprises (SMEs) remain pivotal to economic growth, job creation and general well being of the nation. Most firms can only begin as SMEs and grow to become a limited liability and sometimes a national firm. The SMEs exist in all areas of endeavours and in all aspect of business facets. The SMEs remain pivotal to income generation and national development. The finance available to SMEs is mainly equity finance, and debt finance.

Equity finance has to do with the finance by means of owners' fund, saving by the firm's owner, free gift from friends and families. This most times constitutes the seed capital with which the business kicked off. There is also fund available from financial institutions like loan, bank overdraft and asset financing (leasing) system. The combination of this financial structure will guarantee the growth and expansion of the SMEs. However, most SMEs only operate using the equity finance structure with zero as near zero debt finance.

Most SMEs are not aware of the debt finance option opportunities and where they do, cannot fulfill conditionality of the financial institutions. The cost of debt finance in this environment remain another issue in perspective, there are several debt finance option policies created by the government, yet it least produce result because the SMEs could not asses them. Thus, this study is aimed at exploring the capital structure mix of the SMEs and it overall performance.

Research Problem

The mushrooming SMEs remain pivotal to economic growth of the nation, however, the financial performance; earning, survival and liquidity of these SMEs have been bedeviled over the years by poor capital structure. Most SMEs are financed by all equity and a near zero debt finance, most do not seek debt finance at all because of inability to meet the requirement for debt finance stipulated by the financial institutions especially the conventional financial institutions, that is, commercial banks. The cost of this debt finance remains another bedeviling factor. Thus, this study is design to explore the growth and financial performance impact of the capital structure mix on the SMEs.

Conceptual frame work

Capital structure in finance, refers to the way a corporation finances its assets through the combination of equity, debt, or hybrid securities. It is the ratio of different kinds of securities raised by a firm as long-term finance. The capital structure of a firm described the combination of both debt

and equity finance structure of the firm. A firm's capital structure is therefore the composition or 'structure' of its liabilities. The relative ratio of securities can be determined by process of capital gearing. On this basis, the companies are divided into two namely highly geared companies: these are firms whose proportion of equity capitalization is small. Low geared companies: these are firms whose equity capital dominates total capitalization (Wikipedia, 2012, MSG, 2012)

The Modigliani and Miller (M&M) capital structure relevant and irrelevant theorems posit that in the absence of company taxes, there are no benefits, in terms of value creation, to increasing leverage and on the other hand in the presence of taxes, such benefits, by way of interest tax shield, do accrue when leverage is introduced and/or increased. The capital structure theory by Modigliani and Miller are three types' namely static trade-off theory, agency theory and theories based on information asymmetries (Cohen, 2004)

Trade-off theory of capital structure

In the trade-off theory of capital Structure the bankruptcy cost is allowed to exist. It states that there is an advantage to financing with debt (namely, the tax benefits of debt) and that there is a cost of financing with debt (the bankruptcy costs and the financial distress costs of debt). The marginal benefit of further increases in debt declines as debt increases, while the marginal cost increases, so that a firm that is optimizing its overall value will focus on this trade-off when choosing how much debt and equity to use for financing. Empirically, this theory may explain differences in D/E ratios between industries, but it doesn't explain differences within the same industry. (Strebulaev,2012)

The theory never the less, states that with no taxes, there are no debt-related tax benefits, and with no such benefits [assuming everything else remains constant] there is no optimal capital structure. With no optimal capital structure, therefore, one could only conclude that the whole notion [based on the contention that $E + D = \text{constant}$] of trying to locate the optimal capital structure becomes self-contradictory and, thus, meaningless (Cohen, 2003)

In another study by Cohen(2004) on determination of weighted average cost of capital and firms value in relation to capital structure with intent to locate the optimal capital structure, taking into consideration the relationship between debt, equity and taxes, and placing emphasis on the effects of default risk, as well as on the assumptions that underlie the curves discovered that the conventional optimal capital structure theory by Modigliani and Millan is flawed as is not commonly used in practice,

Cohen also in the study of the difference in the capital structure of depository institutions(banks) and that of the corporate firms .using the basic Modigliani-Millan [M&M] methodology, but instead of using a constant EBIT as stated by (M &M), as classically done for corporate firms used a variable EBIT, which hinges on the interest earnings from the asset-based loans made to the borrower discovered that the optimal capital structure of a depository institution is not as easily identifiable as that of a corporate firms. The reasons for this include, among others, (i) the existence of regulatory capital restrictions, (ii) an inter-dependence between the borrower and the lender and (iii) a dramatic change in the behaviour of the return on equity with respect to leverage when risks and credit spreads of both, lender and borrower, are accounted for. The study also highlighted some of the main differences that exist between the treatment of the capital structure of corporate firms and depository institutions.

Mac an Bhaird (2010) In a study of samples of the capital structure of 299 Irish Small and Medium Scales Enterprises (SMEs) Using hypotheses formulated from pecking order and agency theories and also incorporating a financial growth life cycle approach discovered that the age, size, level of intangible activity, ownership structure and the provision of collateral are important determinants of the capital structure in SMEs.

Zellner(1962) also in a study of the capital structure in several firms discovered that the influence of age, size, ownership structure and provision of collateral is similar across industry sectors, indicating the universal effect of information asymmetries and also discovered that firms overcome the lack of adequate collateral security by providing personal assets as collateral for business debt, and by employing additional external equity .

Murphy, Ofer and Satterthwaite (2009) stated that Modigliani and Miller in their 1958 article showed that if firms are in the same risk class and in an economy with a perfect capital market having no transaction costs, taxes, or no bankruptcy costs, then their relative market values are independent

of their capital structures how ever where they are in a taxable situation then their capital; structure counts in determination of their net return

Pecking order theory

Pecking Order theory tries to capture the costs of asymmetric information. It states that companies prioritize their sources of financing (from internal financing to equity) according to the law of least effort, or of least resistance, preferring to raise equity as a financing means “of last resort”. Hence: internal financing is used first; when that is depleted, then debt is issued; and when it is no longer sensible to issue any more debt, equity is issued. This theory maintains that businesses adhere to a hierarchy of financing sources and prefer internal financing when available, and debt is preferred over equity if external financing is required (equity would mean issuing shares which meant 'bringing external ownership' into the company). Thus, the form of debt a firm chooses can act as a signal of its need for external finance. The pecking order theory is popularized by Myers (1984) when he argues that equity is a less preferred means to raise capital because when managers (who are assumed to know better about true condition of the firm than investors) issue new equity, investors believe that managers think that the firm is overvalued and managers are taking advantage of this over-valuation. As a result, investors will place a lower value to the new equity issuance.(Myers, 1984, Mac an Bhaird ,2011))

Strebulaev(2012) study the capital structure theory using the calibrated dynamic trade-off model to simulate firms' capital structure path and stated that in the presence of frictions, firms adjust their capital structure infrequently. As a consequence, in a dynamic economy the leverage of most firms is likely to differ from the "optimum" leverage at the time of readjustment. It also noted from the results of standard cross-sectional tests on selected data a consistency between the practice and theory of capti9al structure with a little difference and thus suggest a rethinking of the way capital structure tests are conducted.

Leary and Roberts (2012) empirically examine whether firms engage in a dynamic rebalancing of their capital structures while allowing for costly adjustment. They begin by showing that the presence of adjustment costs has significant implications for corporate financial policy and the interpretation of previous empirical results. It confirms that financing behavior is consistent with the presence of adjustment costs and that firms actively rebalance their leverage to stay within an optimal range. Our evidence suggests that the persistent effect of shocks on leverage observed in previous studies is more likely due to adjustment costs than indifference toward capital structure

Methodology

The study is a descriptive study of Small and Medium Scale Enterprises (SMEs) capital structure mix on the performance of the SMEs, the study made use of descriptive method of data collection. The survey method using structured questionnaire to gather necessary data was adopted. The questionnaire was design to have array of sixteen independent questions touching on various aspect of SMEs capital structure mix and the organization overall performance. The judgmental sampling technique was adopted since the opinion of some major SMEs managers reflects the opinion of most other SMEs owner in the environment. Lagos state was selected for the purpose of this study and three local government namely Ikeja local government and Agege local government. Thirty (30) questionnaires were distributed in the three local government, however, only 85 was retrieved out of which only 81 were usable. The chi-square a non-parameter method of data analysis was adopted using a five point likert-scale technique. Stating with Strongly Agreed, Agreed, Indifference, Disagreed and Strongly Disagreed with scale of 5, 4,3, 2 and 1 respectively.

Data analysis and interpretation

Mean ranking and standard deviation

Variables	mean	Standard deviation
Var0019	4.889	0.31623
Var0008	4.778	0.4778
Var0001	4.77	0.41833

Var0002	4.607	0.4667
Var0007	4.667	0.47434
Var00016	4.667	0.47434
Var0010	4.44	0.5000
Var00013	4.44	0.68920
Var00013	4.44	0.58920
Var0009	4.33	0.47434
Var00015	4.233	0.47434
Var00018	4.222	0.79057
Var0004	4.000	0.47434
Var00014	3.889	0.47434
Var0003	3.55	1,17260
Var0005	3.333	1.16190

The mean of the various variables stated their spread and convergent to the centered while the standard deviations state the divergent of the variables value from the center both represent the rating of the variables and their value to the issues being measured. The mean is used to determine the value ranking of the variables to the measured phenomenon variable 0019 or var 0019, seems to be strongly favoured as a high impact variable to the financial or capital structure of the SMEs, such that “SMEs should seek financial expansion using various government investment loan schemes” is of the highest value.

The variable that state that all equity finance by SMEs hinders its growth due to the small size of the equity finance (Var 008) stands second while Var 002 which state that “A wrong financial structure when adopted by the SMEs could lead to its collapse “ come next, moreover Var 007 which state that capital structure of the SMEs could affect it overall financial performance is of high impact too. These four variables portend high value to the study above others, the least valuable variable being “ Do you use more of debt finance than equity finance, which connotes that most SMEs in Nigeria do not have access to debt finance which tend to hinder their expansion come last

Test of Hypothesis

Sources and structure of finance of SMEs is not a sine-qua-non for SMEs growth and survival

Table1:

	X ² cal	prob
Var001	25.00	0.000
Var0013	24.00	0.000
Var0018	6.00	0.000

The Hypothesis or the research problem was tested using three variables as in table1 , using 95% confidence level the three variables were significant at 0.05% significant level with probability value of 0.000,0.000 and 0.050, for variables 001,0013,0018 respectively, variables 1 and 13 are strongly significant than variable 18. It means that for a small and medium scale enterprise to survive and grow good financial structure and good sources of fund are of high value.

Hypotheses 2

The cost and stringent policies attached to debt finance is not a inhibiting factor to debt finance by SMEs

Table2

	X ² cal	Prob
Var0002	9.00	0.003
Var006	11.00	0.002
Var009	9.00	0.003
Var015	9.00	0.003

The research problem or hypotheses was tested using four variables as above, the asymptotic probability was used and all the test variables were all significant at 5% significant level. Thus, the cost and stringent policies regarding debt finance remain an inhibiting factor for debt finance option by the SMEs

Hypotheses 3

Capital structure of SMEs do not affects the overall performance of the SMEs.

Table 3

	X ² cal	prob
Var007	9.00	0.003
Var003	75.00	0.000
Var0014	43.00	0.000
Var005	34.00	0.000
Var0019	49.00	0.000

Four variables were used to test the significance of capital structure and overall performance relationship of SMEs, the variables were all significant at 5% significant level, this means that finance mix (or capital structure) of SMEs bear a significant sum to it overall (financial and otherwise) performance of the SMEs

Hypotheses 4

Equity finance size of SMEs do not inhibit it long run growth potential

Table 4

	X ²	prob
Var004	72	0.000
Var008	25	0.000
Var010	1.00	0.317

In table 4 three variables depicting the relationship between equity finance size and SMEs long term growth potential were stated. Two of the three variables were significant at 5% significant level which are var 004 and var 0008 while var 0010 is not significant at either 5% or 10% significant level.

However, the variable significance revealed that equity finance by SMEs does influence it.

Conclusion and Recommendation

Conclusion

The study exposes the relationship that exists between the capital structure of SMEs and the overall organization performance. The capital structure is the mix of debt and equity finance by the SMEs.

The study revealed that most SMEs use equity finance at a far higher level than debt finance partly due to ignorance and the stringent policies of debt finance in Nigeria.

Moreover, SMEs in Nigeria remain small due to inability to raise capital from the financial institution for expansion.. The high cost of debt finance is another militating factor against the SMEs debt finance usage. The high cost of debt finance made it inaccessible for expansion by the SMEs. The survival and liquidity of the SMEs the study discovered is mostly inhibited by poor finance and inability to eqiuty/loan finance.

The study discovered that in the Nigerian peculiar circumstance the suggested Modigliani and Milan 99% to 1% debt equity ratio cannot work, and in fact most SMEs finance by 99% to 1% of Equity to debt ratio. Gthe study also revealed that the optimal capital structure orchestrated by Modigliani and Milan is impracticable and unattainable in the peculiar circumstances' of the SMEs in Nigeria. The return and the overall performance of the SMEs are influence by the capital structure mix

Recommendation

The study exposed the factors as relating to financial structure influence on the performance of SMEs. From the foregoing, the following are the recommendation from the study

The government should design home grown and grass-root SMEs policy of finance for SMEs.

The SMEs managers should also be enlightened on various debt finance possibility for growth and expansion. The SMEs owners should be educated on the implication of various source of finance on the organization performance. The government should deliberately design a low cost debt finance policy meant specifically for the SMEs this will boost investment at that level and will also encourage employment.

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PROBLEMS AND PROSPECTS OF RETIREMENT ADJUSTMENT ON FAMILIES OF RETIREES AMONG CIVIL SERVANTS IN EKITI STATE, NIGERIA

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Abstract:

Retirement is the act of retiring or the state of being retired, i.e. to withdraw oneself from business, public life or and to remove from active service. Data for this study were collected from primary and secondary sources. A total number of four hundred (400) questionnaires were administered in this research work, out of which three hundred and seventy eight (378) were returned. The questionnaires were administered using purposive and stratified random sampling techniques. Descriptive and frequency tables, using percentages were adopted in the analysis of the data collected. Results from the study revealed that delay in payment of pension; maladjustment and psychological adjustment were some of the problems of retired Civil Servants in the study area. This study therefore recommends that various establishments in Ekiti State should be encouraged to organize retirement counselling for their workers to enable them prepare for the obvious eventuality.

Key Words: Civil Servant, Ekiti State, Problems, Prospects and Retirement

Introduction

Retirement is an age long practice in both the private and public service (Osuala, 1985). He stressed that it is a major stage in adult development and it essentially marks the split from middle years to old age. He further noted that at 65 years of age, our mental and physical exuberance dwindles; it however becomes rationale to relieve the person of some strenuous and excruciating duties that may weigh him down and consequently threaten his health. This, therefore, results to the retirement age of 65 in developed and economically buoyant countries. But in Nigeria, due to economic crunch and high rate of unemployment, the minimum legal age for mandatory retirement was put at 55 until recently when the Federal Government of Nigeria pegged it to 60 years.

Retirement as defined by Atchley (1977) is the act of retiring or the state of being retired. That is to withdraw oneself from business public life or and to remove from active service. Thus, the process of retirement involves the transition of people's experience, when they move from a job role performed for pay to the role of retired person.

The role of a counsellor is not complete until an individual is able to realize himself and the realities of the world around him and also maximize his potentials in order to cope with life demands. Counseling for the retirees is becoming very necessary in view of the various problems they are facing.

Bukoye (2005) in her study suggested that the Federal Government should establish retirement bureau in each state to address problems of retirees and to assist them from wasting away. It is against this background that a work on problems and prospects of retirement on families of retirees among civil servants has become imperative.

A close observation of many retirees in the Nigerian society and the problems they are facing draw the attention of all and sundry. These problems seem to range from sudden loss of life, loss of the usual monthly salary, anxiety about a residential home, lack of occupation, dwindling status, decreased strength and deteriorated health condition, physical disabilities and aging.

Harris and Cole (1980) noted that retirement may be a ceremony between one career and another; it may represent the opportunity to start one's real life work or to draw two pay checks. In addition, they further explained that second and even third careers are becoming more common

among men and women whose first career is motherhood. They viewed retirement from a chosen career to active participation in other careers. This view point presents an interesting side of retirement. In Nigeria society today, the researcher observed that some retirees have been engaging in other activities after retirement, some have been actively engaged in politics, some in industries/private establishment while some are giving academic leadership in various Institutions particularly tertiary Institutions.

However, according to Bolarin (1998) retirement to some people is like a bitter pill and could be viewed from different perspectives. Omoresemi (1987) stated that retirement is a real transition, transition in the sense that it is the passage from one place, stage of development to another. He was also of the opinion that the transition could mean passage from the former business career of active services to another, a second stage of life development. This submission has relationship with the postulation of Harris and Cole (1980). Manion (1976) defined retirement as the First life step that convincingly defines a person as old. It is a withdrawal from customary activity in business industry or service.

In the work of Ogunbameru (1987) retirement had indeed been considered a crisis situation for most retired public servants in Nigeria. His view was contrary to that of Manion (1976) which admitted that retirement is withdrawal from customary activity in business or industry or service. Ogunbameru (1987) showed that retirement is more than withdrawal, rather, it is a major crisis especially in Nigeria because there is an absence of pre-retirement counselling given by employers to employees, which would generate changes that normally facilitate the transition from work to retirement may be perceived as resulting into loss of status especially, if the retiree is a bread winner. His view corroborated the findings of Anyah (2000) who stated that teachers in Ghana feared to and were refusing to go on retirement because of boredom and loss of sense of self worth and security that they observed about retirement.

There were situations where pensioners were owed huge amount of money as monthly pension arrears. When little out of the monthly pensions are paid, the pensioner usually face serious administrative bottleneck to the extent that some die on the queue in a bid to collect what actually belong to them. The above stated submission calls for adjustment among the retired Public Servants. The irregular payment of pension often leaves them at the mercy of their children and these children may not even have enough to take care of themselves let alone their aged parents.

Already a great number are languishing in the rural and urban communities for failure to plan for their retirement and more are being disengaged yearly into this training of retirement. There is need, therefore, to find answers to the following questions:

1. Will the level of income influence the adjustment of retired Civil Servants?
2. Will size of family influence the adjustment of retired Civil Servants?
3. Is there any relationship between economic, social, health, psychological, gender, nature of retirement, size of family and level of education adjustment variables of retired civil servants?

The study area

Ekiti State is located between latitude $70^{\circ} 30'$ and $8^{\circ} 15'$ North of the equator and longitude 447° and $5^{\circ} 4' 40''$ of the Greenwich Meridian. Ekiti State was created on the 1st of October, 1996 and its capital city, Ado-Ekiti has witnessed rapid population growth and urbanization (Awosusi and Jegede, 2010).

The relief of Ekiti State consists of undulating plains. The highest contour line of 540m above sea level is found around the North Eastern limit of the state. The rocks are dominated by the basement complex geology of the Southwestern Nigeria.

Ekiti State has a total annual rainfall of about 1400mm with a low co-efficient variation of about 30% during the rainfall peak months and with an average of about 112 rainy days per annum (Adebayo, 1993).

The development of Ekiti State spread towards the routes of communication put differently, the settlement evolutionally structure and growth is a replica of Homer Hoyt's Sector Theory of 1939, which posits the sprawl of physical development in the direction for transportation routes.

Conceptual framework/literature review

The Concept of Retirement by Schuster and Ashburn (1980) is applicable to this study. Thus, retirement they said could be seen as an event that occur at the end of a specified work period.

Secondly, those individuals (usually over the age of 45) who have experienced difficulty in obtaining employment may after a period of time considers them to be retired. The above assumptions implied that the choice of meaning and interpretation of retirement vary, but all imply the concept of separation from regular / full time employment.

In the work of Ekah (1987) he found out that occupational status was not important in determining the adjustment level of retirees. Kerkoff (1996) reported that 5 years before retirement almost half of the 1000 subjects he studied were worried about forced retirement because of their inability to surmount the ensuing adjustment needs for food and shelter.

Religious affiliation did not influence the adjustment needs of the retired Civil Servants in the ethnic study of the adjustment needs of retired Nigerians carried out by Ogidan in (2005). He explained that this was probably because of the fact that both Christians and Muslims generally have similar religious provisions in helping the needy like the retirees to alleviate their suffering which also accounted for their similarities in the pattern of what they claimed to be their retirement adjustment needs.

Methodology

This section presents the research design, population, and sample, sampling techniques, research instrument, validity of the instrument and reliability of the instrument, administration of the instrument and data analyses.

Research Design

Descriptive research of the survey type was used in this study. This method was adopted because the study focuses on the problems and prospects of retirement on families of retirees among civil servants in Ekiti State, Nigeria. The design allows for information from the representative sample of the entire population.

Population

The population considered for this study consisted of all the retired civil servants in Ekiti State, Nigeria. The total number of Civil Servants in the state as at the time of this study was 8,962 (Ekiti State Civil Service Commission). This consists of Civil Servants from the 16 Local Government Areas of Ekiti State.

Sample and Sampling Techniques

The sample was 400 Civil Servants (Male and female) in Ekiti State selected from all the 16 Local Government Areas of Ekiti State based on purposive and stratified random sampling techniques.

Administration of the Instrument

Four hundred copies of questionnaires were administered on the identified retired Civil Servants across the sixteen Local Government Areas of Ekiti State but 378 copies were retrieved from the field.

Data Analysis

Frequency count, percentage and mean were used to analyze the questions generated in this study. The variables were social, health, psychological, level of income, gender, nature of retirement, size of family and level of education.

Findings and discussions

Findings

Table 1: Level of Adjustment of Retired Civil Servants

Level of Adjustment	Frequency	Percentage
Low	67	17.7
Moderate	227	60.03
High	84	22.0
Total	378	100.0

Source: Fieldwork Report, 2010.

The mean score (68.6) on adjustment and standard deviation (8.38) were used to categorize the subjects into three (low, moderate and high.) The minimum and the maximum scores on adjustment were 40.0 and 80.0 respectively, subjects whose scores fell between 40 and 60.24 were

said to have low adjustment, and participants who scored between 60.25 and 76.9 were classified as “moderate” adjustment, while the respondents whose scores on adjustment fell between 77 and 80 were grouped as “High”. The results were shown in Table 1 above.

Findings revealed that 67 (17.7%) of the respondents experienced low adjustment, 227 (60.03%) of the subjects stated moderate adjustment, while 84 (22.0%) of the respondents observed high adjustment level. This suggested that majority of the retired Civil Servant in the study area experience moderate adjustment.

Table 2: Psychological Adjustment of Retired Civil Servants

	No		Yes	
	N	%	N	%
I am quite happy as a retiree	100	26.5	278	73.5
I do not feel neglected or dejected as a retiree	92	24.0	286	76.0
I do not have a feeling of inferiority complex as a retiree	95	25.1	283	74.9
I have self esteem in my community as a retiree	93	24.6	285	75.4
I do not regret that I left the Public Service	91	24.0	287	76.0
I still have a good relationship with members of my establishment	70	23.8	288	76.2
I still have a good relationship with my friends	73	19.3	305	80.7
I still have a lot to contribute to the society	89	23.5	289	76.5
Many people appreciate what I have contributed to their lives	71	18.7	307	81.3
I have a sense of accomplishment as a retiree	76	20.1	302	79.9
Percentage total		36.25		63.75

Source: Fieldwork Report, 2010

Findings from table 2 revealed that (36.25%) of the subjects were likely to be having psychological adjustment problem while (63.75%) of the subjects were seemingly not having psychological adjustment problem. The results of these findings showed that majority of retired Civil Servants in Ekiti State might not be having psychological adjustment problem.

Table 3: Nature of Retirement

Nature of Retirement	Frequency	Percentage
Voluntary retirement	2.20	58.20
Compulsory retirement	1.58	41.80
Total	378	100.00

Source: Fieldwork Report, 2010

Findings from table 3 showed that 220 (58.20%) of the respondents stated voluntarily retirement, while 158 (41.80%) of the respondents noted compulsory retirement. This indicates that majority of the retired Civil Servants within the study area retired voluntarily, when they get to retirement age/number of years of service, rather than being forced out of labour force.

Discussions

Some of the problems that necessitated this study were the problems being faced by retired Civil Servants as expressed in the media and the pensioners. These problems include delay in the payment of pension and maladjustment arising from economy, social health and psychological variables. The resultant effects of the problems observed includes; sickness, rejection and even untimely death among the retired Civil Servants, it was discovered that there is no significant difference between the psychological adjustment of male and female retired Civil Servants.

Most of the respondents both males and females indicated that they have a sense of accomplishment as retired Civil Servants. Ekiti State being an agrarian and educational environment provided the retirees with opportunities of psychological support arising from educational opportunities, that is, teaching in private schools and engaging in subsistence farming, however, this view is contrary to the view of Bungston (1969) who found out that retirement is seen as hindering social activities through the process of removal of the individual from a functional location in society. This in turn makes the retirees to be dissatisfied with the present predicament in Ekiti State; many of the retirees became adjusted because they were busy with peasant farming and part time teaching. These opportunities made them to be happy as retirees and invariably many of them were psychologically adjusted either male or female. This finding agrees with the submission of Keras (1977) that some retirees enjoy the relaxation of retirement as it is now a time of rest after a long life of labour.

Conclusion and recommendations

It can be concluded from the findings of the study that factors such as the nature of retirement, size of family, level of income and level of education are significant indices that determines the level of adjustment among the retired Civil Servants and the best predictor of adjustment in retirement among Civil Servants in Ekiti State is social factor.

The various establishments in Ekiti State should be encouraged to organize retirement counseling for their workers to enable them prepare for the obvious eventuality.

The government should minimize the bottleneck that is usually involved in payment of gratuity. Gratuity should be paid within a month after leaving the service.

Workers should be encouraged through conferences and seminars on manageable number of children they should have.

Government should encourage its staff to buy shares in profitable companies to enable them have additional means of income after retirement.

The Management of Pension Fund should be given to Private Pension Administrators with credible records in order to forestall mismanagement of Pension Fund.

The Government should endeavor to provide Recreation Centre for retired Civil Servants in Ekiti State to enable them have the opportunity for social interaction.

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TRANSDISCIPLINARY CHALLENGES OF SUSTAINABLE CONSTRUCTION AND REAL ESTATE DEVELOPMENT IN VISEGRAD COUNTRIES

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Abstract:

The Visegrad countries – the EU members - are the most advanced transition countries, yet they face the serious problems, such as the dependence on the energy sources from abroad. Similarly as other European countries they are obliged to meet the goals of the European Union in the area of energy savings in future (document Europe 2020). The special measures have been undertaken by some of the countries but the overall results were to this moment quite controversial. The most important challenges are:

- High costs of the energy from the renewable sources in times of economic austerity,
- Lack of innovation capacities,
- inadequate funding of the research and development and the problems of transition to market economy,
- Low support for transformation of the energy sector towards the use of renewable resources by the society,
- Need for additional investments into the power grids,
- The growth of consumerism,
- Urban sprawl combined with very liberal approach to urban planning and development,
- The mainstream political attitudes concerned especially with growth of wealth but not with protection of the environment and energy savings,
- Difficulties of the implementation of the efficient energy savings measures in the housing sector because of low solvency of often aging population.

The aim of the paper is the identification of barriers and the suggestions of possible policy changes that would help to overcome the present problems.

Key Words: Renewable energy resources, real estate, Visegrad countries

Introduction

The economic dimension of sustainable development is based on the assumption that is impossible to maintain urban infrastructure and real estate fund in working order, to ensure prosperity and maintain at least minimal economic growth without an adequate level of economic activity. Economy where energy costs are rising (they are a growing source of environment pollution), while economic growth is based on the use of non-renewable resources, then such economy can not be regarded as sustainable. Sustainable development requires a transformation of the whole system in the direction of environmental and social compatibility. The economic, political, environmental and social aspect have to be taken in account.

Visegrad countries and energy security

Cooperation of the Czech Republic, Hungary, Poland and Slovakia within the Visegrad Group has its roots in the period of Soviet Union dissolution. These four countries after 1989 got into the geopolitical vacuum and mutual cooperation was the logical result of given situation. The official platform of cooperation formed on 15th February 1991 in Hungarian town of Visegrad. Czech and Slovak federal Republic, Hungary and Poland then signed there a declaration of mutual cooperation and created so-called Visegrad triangle. In 1993, after the split of the Czech and Slovak federal Republic, the group was renamed to Visegrad Four (V4) and it represent an informal grouping of four

central European countries that subscribe to the same values, have a common history, culture, geographic position and also have a number of common features in energetic sphere:

- high energetic usage,
- high dependence on import from Russia,
- high dependence on imported primary energy sources,
- low share of renewable sources of energy in the energetic mix,
- market liberalization,
- links between Eastern and Western Europe,
- efforts to increase the installed capacity of renewable energy sources (obligations towards EU) and the resulting problems.

Tab. 1 Energy dependence of Visegrad Countries

Visegrad countries	1990	2000	2010
Czech Republic	15.7%	23.4%	25.1%
Hungary	50.4%	56.1%	61.4%
Poland	2.2%	11.2%	25.5%
Slovak republic	76.7%	66.0%	67.0%

Source: SE, a. s., 2012

Energetics and strengthening energy security is one of the most important areas of cooperation of V4. This sector was developed primarily in the period in which the V4 was part of the socialist block. This period was characterized by the V4 guarantee of cheap imports of oil, natural gas and nuclear fuel from Russia, extremely energy-intensive economies, which were not forced to efficient and intensive use of resources and industry had a huge negative impact on the environment. Typical is also infrastructure, directed from east to west, parallel through the countries of V4. A serious problem of these countries is that they are heavily dependent on energy supplies from a single source, and lack of an integrated common market. Research shows that the situation in the V4 is better in terms of oil and liquid fuels, but worse in the supply of natural gas. Gas crisis in 2009 in Slovakia particularly showed that the resources invested in the development and modernization projects in the energy sector are ultimately more profitable than any energy supply disruptions. Natural gas is a major part of the total imports of energy resources, while 92% is imported from one country - Russia. The priority of the V4 countries should therefore be getting rid of this dependence. An important challenge that is sensed especially by Poland and the Czech Republic is the rising cost of greenhouse gas emissions, which may have a destabilizing effect on the economy dependent on coal. Access to alternative sources of supply reduces the risk of loss from one source and is a fundamental security principle of continuous flow of energy materials supply. Recently, renewable energy sources (RES) has become one of the key issues in the debates on energy whereas the impulse are the objectives of the European Union in 2020 and the share of renewable in the energetic mix.

Tab. 2 Share progress of renewable energy sources in V4

Country	Year 2010	Year 2011	Target 2020 according to Regulation 200/28/EC
Czech Republic	9.2%	10.4%	13%
Hungary	8.7%	8.2%	13%
Poland	9.6%	10.6%	15%
Slovak republic	9.8%	9.5%	14%

Source: SE, a. s., 2012

Sustainable development and eco-innovation in the construction industry

In the development of sustainability, construction sector plays an important role for several reasons:

- is a key sector in the economy of each country, the infrastructure and living conditions are essential in Determining the Quality of Life,
- providing employment opportunities in construction, operations and maintenance activities have a significant impact on poverty reduction.

Energetic efficiency is the key to a sustainable energetic policy and contributes mainly to:

- energetic security,

- environmental sustainability,
- increasing competitiveness.

The aim of the realization of energetic efficiency is mainly to ensure the availability of energy for all end users in real-time and cost effective basis (Petráš, D. and team 2009). The professional analysis show that the total energy consumption in Europe the construction sector accounts for at least 40% of total electricity consumption 11% and 50% of the consumption of raw materials. Construction and demolition activities in this sector produce 40 to 50% of total waste, though in a large extend recyclable. In the sustainable construction, participants should keep in mind environmental, socio-economic and cultural aspects such as design and management of buildings, materials selection, operations buildings, interaction with city and economic development (Baláž, I. 2009).

To reduce energy consumption, thus improving the energy efficiency of building operation can contribute significantly to traditional solutions aimed at balancing thermostats, insulation or modernizing heating and cooling, which ultimately leads to costs decrease. This applies to all buildings, whether residential, office or factory. On the other hand, investors should not rule out the possibility of connecting buildings to the existing centralized heat sources (CHS), which can by its flexibility prevent fuel base being dependent on a single media. In post-socialist countries after 1989 there was a disconnection of the centralized heat sources not only by the major consumers but also by apartments. Today, these systems are built at a disproportionately larger costs in Western EU countries. It allows operation of centralized heat source to solve many of the current challenges facing the energy industry. It is not possible to economically and ecologically realize RES without CHS. In Slovakia, in some cases, small towns and cities began to build a small network of district heating, which heats local schools, small apartment buildings and so on. Such a solution is also possible for individual construction when building a whole new neighborhood houses. Another option for older, as well as new individual construction, the elimination of gas by the financially and structurally more accessible heat pumps or using solar collectors.

Energy usage in the Visegrad countries in the period 2002-2008 is presented in fig. 1 from which it is clear that the largest percentage decline in energy usage among OECD countries of 33% is represented by Slovak Republic.

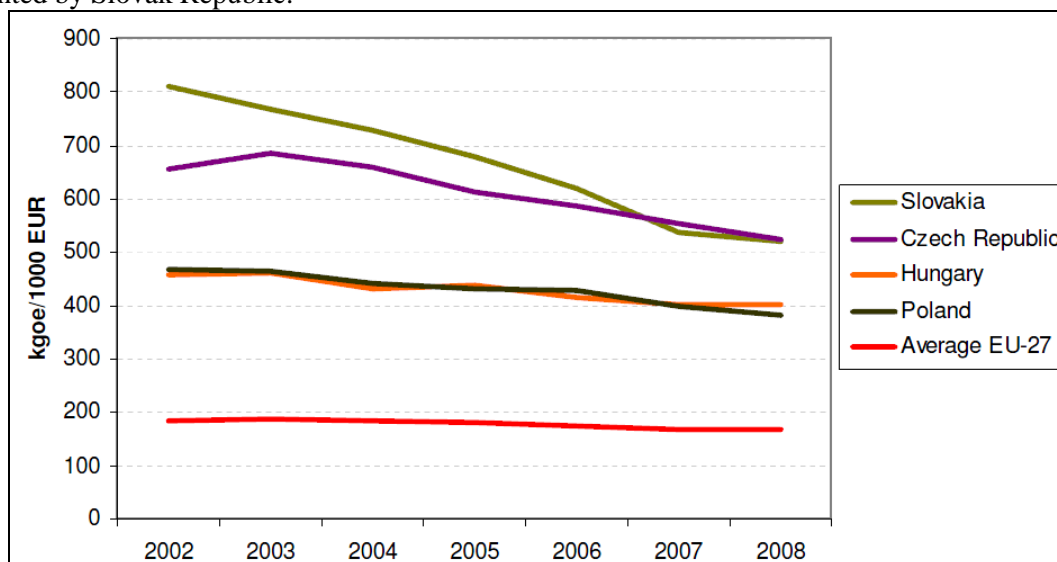


Fig. 1 Energy intensity in Visegrad countries (kgoe/1000 EUR)

Source: Žáková, A.: Energy Policy of the Slovak Republic, 2011

Report of the World Commission on Environment has defined sustainable development as a mechanism, through which it is possible to ensure the needs of current generations without limiting opportunities to meet the needs of future generations (Jeck, T., 2012). Strong emphasis is given to link economic growth and gradual environmental degradation. According to Carrillo-Hermosilla and team (2009) on the economic theories of the relationship between environmental sustainability on the

one hand and economic growth and competitiveness on the other hand, can be presented in two basic views:

traditional - neoclassical view understands the relationship of environmental sustainability and economic growth performance than the decision in favor of one over another. The environmental degradation is seen as a market failure resulting from the separation of ownership and negative externalities arising from production. Protection of the environment by policy measures in this sense are always additional costs for companies and reduction of their competitiveness.

On the other hand, so-called **revisionist view** is based on technological change and innovation. This approach open possibilities to internalize environmental issues into economic processes themselves. Under this approach, the application of environmental policy instruments is forcing companies to innovations, which reduce production costs and improve the competitiveness, but also have a significant impact on the economy of the country.

Within the EU economic policies, the new green technologies are seen as one of the tools which will increase the competitiveness of the economy. The Europe 2020 strategy formulated the issue of eco-innovation in the flagship initiative "Innovation in Union" at the european level. Eco-innovations are normally defined as innovations whose primary purpose is to reduce damage to the environment and the nature by various scientific disciplines, such as institutional and evolutionary economics, industrial economics, systems analysis and operations research, knowledge management, organizational change management and so on (Carrillo-Hermosillo, J. and team 2009). The attention of the European Commission is aimed to "complete the European Research Area, to develop a strategic research to solve major challenges such as energetic security, transport, climate change and resource efficiency, health and aging of population, environmentally-friendly production methods and land management and increased collaboration in joint programs between Member States and regions "(EC, 2010).

Development of urbanization

In terms of sustainable development in the urban development, the important role is played by housing as a basic component of the urban environment and social development. The statistics show that:

- 68% of the population of EU countries live in urban areas,
- 85% of EU GDP is generated in cities,
- urbanized areas represent about 70% of the total primary energy demand,
- energy consumption in urban areas is growing annually by 1.9% (compared to 1.6% globally),
- municipalities are part of the problem but also part of the solution.

According to the reference scenario of the International Energy Agency, "urban" energy consumption will grow twice as fast compared to the EU as a whole. Cities and regions have great potential for the realization of energy efficiency measures and using renewable energy sources with a positive impact on the local economy, employment, investment and innovation.

All V4 countries (at differentiated rates) confront negative effects due to trade liberalization, income disparities and the development of well-paid social class, as well as the growing number of cars during the transformation of urbanization development. This effect is most visible in the metropolitan areas of major cities (Budapest, Warsaw, Prague, Bratislava). The same trend occurred in the case of other major cities. At present, the suburbanization tendencies are constantly getting stronger. They are related to the migration of urban population to the surrounding "green" zones in the 90s of the 20th century. Installation of a so far free country still brings negative consequences. Creates inefficient and unregulated structures(sprawl)of land use, which will for a long time obstruct sustainable urban development.(Gremlica, 2002).

Uncontrolled spread of cities into the country, manifesting in all V4 countries, is disorganized and uncontrolled by definition. The situation is additionally complicated by the fact that land use planning have relatively weak instruments. Corrupt behavior is evident at the local level at issuing permits and making decision throughout the whole Visegrad region. Supported are investments in developing on new "green field" and large devastated or otherwise unused areas (brownfields) remain unnoticed. As a result, the built-up area extends about 1% per year, with a serious impact on local hydrological cycles, the structure of the country, local climate, landscape, biological or cultural diversity and many other things.

From the economic, social and environmental point of view, we can characterize "sprawl" (spread build-up in the country side) as undesirable form of suburbanization (Ouředníček, M. 2002). It is the uncontrolled and unconsidered placement of residential or commercial real estate in the country, which is typical of Visegrad Countries. The result is usually mosaic structure in newly developing urban areas. The main force of such development are efforts of individual landowners or developers to maximize their profits. Locations which are marked by sprawl, increase of economic costs and reduce quality of life in suburb. It is mainly caused by lack of territory connection, lack of roads and sidewalks, garbage collection, maintenance in winter, introduction and management of technical, social and transport infrastructure, and extreme dependence on the personal automobile.

Smart cities and smart urban Technologies

The requirement of the quality of life for people who live in cities causes big pressure on urban infrastructure and available natural resources. To determine the degree of influence of human activities on the environment is used so-called carbon footprint. That it could be reduced by cities, they must pay more attention to the factors that have a direct impact on the level of CO₂ emissions. For example, the quality of the grid, the energy efficiency of physical infrastructure such as buildings, and transport energy consumption. It is estimated that missed productivity and energy consumption due to traffic jams is 1 to 3 percent of world GDP. A significant contribution to the sustainable development of European cities may have Smart Urban Technologies. In EU, 68% population lives in urban areas, proportion which is growing as the urbanization trend continues in Europe and also worldwide. In 2050, nearly 70% of the population potentially will be living in cities. They consume 70% of energy in the EU and there are up to 75% of greenhouse gases emitted by the EU. Initiative on Smart Cities and Communities (SCC) was found in 2011. The Smart Cities and Communities, European Innovation Partnerships (EIP) are partnerships across the energetic areas, transport, information and communication with the objective to create progress in areas where transport, distribution, mobility, use, and production of energy, information and communication technologies (ICT) are closely linked and offer new interdisciplinary opportunities in service improvement while reducing resource consumption, energy and greenhouse gas (GHG) emissions and other emissions which pollute the environment (Fig 2).

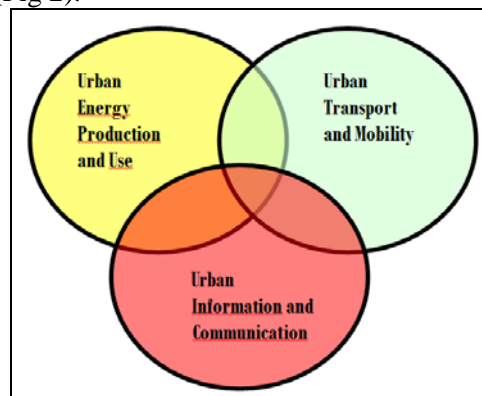


Fig. 2 The SCC focuses on the intersection between energy, transport and ICT
Source: Smart cities and communities -European Innovation Partnership, 2012

The next logical step is to scale up a comprehensive and integrated way the undertaken efforts are related to the urban energy efficiency components of the Strategic Energy Technology Plan in the year 2013. SCC Focuses on innovation led by industry as a key driver to achieve changes in economic and social aspects in urban areas and promotes actions across the cycle of innovation and across different sectors. It will support existing and future initiatives of EU for urban areas in the environmental field (resource efficiency, water, waste, pollution, green infrastructures) and climate policies (EC, 2012).

An important part of EU commitments for 2020 in the field of energetic efficiency and emissions is an innovative scheme for smart cities, where the European Commission supports the development of sustainable technology projects in cities and communities in the areas of energy, transport and information technology in the amount of EUR 365 million.

Conclusion

The current direction of Visegrad countries is unsustainable in many ways. For serious issues to be considered as widespread corruption, high degree of unemployment, a growing deficit of public budgets, lack of innovation capacity and so on. These facts present a serious challenges which politicians are facing in the Visegrad region. It must be said that similar problems are experienced by other European countries. In the field of urban development, management tools of suburban development are very limited at the regional level. The responsibility lies on the decisions of mayors and municipal councilors, developers, building offices, suburban communities and people who can influence the extent, location and impacts of new construction, but not always effectively and efficiently. Environmental pillar of the V4 region is far from the objectives of environmental sustainability. In other words, results and improvements made in this direction in the Visegrad countries are compared with the rest of the world in the context of global issues were disappointing. It also must actively deal with some global threats (climate change, biodiversity reduction, etc...) as well as regional and local issues (increasing pressure from individual motorized transport, municipal waste production, suburbanization,..). Finally, the introduction of new technologies in urban practice will take time, because of the "strong personal interest and reluctance to overcome barriers" in areas such as IKT, transport, energy, health care and waste management.

Many organizations produce estimates of the global energy situation, especially with regard to the demand for energy, efficient energy mix (use a combination of different sources of energy) and security of supply. Reports and analysis serve different economic and political targets, but also interests. They differ in focus and methodology, so it is quite difficult to compare.

European Union seeks to significantly promote "green projects" through financial programs and tools that are available to support activities in research, development and demonstration of smart grid projects, as well as direct investments in the necessary infrastructure.

On the other hand, the local private financial institutions are declaring an interest in funding "green projects", but conditions are scheduled for a specific project individually. Options for funding new technologies and innovative projects in the field of residential construction are associated with many obstacles, despite the fact that intelligent technological solutions are economic benefits for both the regeneration of buildings and new construction. These barriers relate to access the residential real estate sector to the public (support programs) or private finance (from banks, energy service companies, etc.) of those market participants who want to invest in measures to improve energy efficiency, but on the other hand, are unable to appropriately and adequately secure the loan. Increasing the price of the project are presented by the transaction costs associated with obtaining financial resources and banking institutions which include various disproportionately high fees, which go to the pockets of financial services providers.

In conclusion, the global investment in "green projects" in 2009 significantly increased (as the WEF report, based on data from Bloomberg New Energy Finance), which is considered to be a significant positive.

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ECONOMIC TERMINOLOGY – NEW PERSPECTIVES

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Abstract:

The analysis starts from the premise of the differential partial behavior of terms in various types of economic discourse – scientific and environment related (in the economic press of wide circulation). Examples considered concern the preservation of the hard core of the specialized meaning and the conceptual-semantic effects triggered by contextual combinations in different types of texts. The terminological variation in the current economic texts is primarily conditioned by the evolution of companies, and the economic press of wide circulation is forced to reflect the dynamics of changes, which happen before our eyes, and are not yet reflected in the strictly scientific texts since they develop slower. The strict extra-linguistic determination entails a more rigorous use of the economic terms, with definitions and inter-conceptual relations manifested at the level of the terminological density, which are rather high in texts of wider circulation.

Key Words: Economic terms, terminology, variation, syntagmatic and paradigmatic analysis

Introduction

Terminology – Theory and Practice

The analysis of the *terminological variation* is based on the common idea that it has similar forms to the linguistic variation, in general. The causes of *variation* are diverse and can be studied from at least two perspectives: on one hand the type of terminology is investigated: more a terminology is recent or emerging, more the conceptual-semantic and denominative inconsistencies are frequent and, therefore, the *variation* is present at all levels: cognitive (conceptual), linguistic and situational, on the other hand, in terms of communication, in certain contexts, a lexical variant is preferred over the term that appears in the specialized dictionary.

The role of linguistics in terminology is presented in this paper, outlining at the same time, an interdependent and independent subject. Adopting several unitary analysis methods leads to a *linguistic and descriptive subject*, which according to its goals, falls into a *lexical terminology* and a *textual/discursive terminology*. It is also specified the achievement of the terminological research, in accordance with the connection between dictionaries and texts.

Main Text

Current terminology studies show the importance of using real terms in texts and contexts, differentiating the term – label from lists, dictionaries, etc. from terms in use. Objective criteria are proposed to distinguish texts depending on the density of specialist terms in context or their dissolution by using common words. A preliminary analysis of terms in texts and contexts concerns the relation between the lexicographic definition, that must be a natural definition (and therefore accessible) and the terminography definition, reproducing the scientific definition and which is conventional. Specifically, these distinctions are not rigid, because there are other types of classification of definitions which take account of conceptual-semantic aspects (the ability to describe the referent in substantial definitions or to appoint phenomena, concepts and abstract relations in relational definitions (see A. Bidu-Vrăncănu 2007: 52-54). There are other aspects to be taken into account as regards the type of definition grounded on similarity (designation of quasi-synonyms), association or opposition (antonymy), (id). These ways of defining influence in various ways and degrees the access to specialized purposes.

When the term passes a strict field, affecting various larger groups of speakers, the pre-scientific or usual definition is deemed convenient. Such definitions should be preferred for scientific and technical terms in general dictionaries or mass media communication, even though they provide

only partial knowledge. Partial decoding of specialized meaning by profane speakers in a particular area is broadly called de-terminologization (see A. Bidu-Vrănceanu 2007). The de-terminologization degree depends on many factors and different abilities of speakers, their gaps in knowledge that affect the definitions' "reading" (see A. Bidu-Vrănceanu 1993: 58-63, 2007: 71-103).

Placed interdependently between synchrony and diachrony, is the analysis of terms and terminology, due to the fact that "cognitive and linguistic patterns are essentially open" (Gaudin 2003:62, 72, 73, from 75, 96-97). Therefore, the *denominative cognitive variation* is a priority and has various reflections both in synchrony and in diachrony. Among the relevant aspects of this perspective, it is worth noting the relationship between a domain and its subdomains, the development of new branches by hyper-specialization. (Balliu 2006:476,478; Ouerhami 2006: 441-442; Bidu-Vrănceanu 2010: 159-179; 229-239) , the denotative mobility of certain terms, subject to scientific review of the interpretation (Bidu-Vrănceanu 2010: 39-42; 67-69), terminological dynamics (terminological or semantic neology).

The *synchronic perspective* in terminology is almost general, both at the level of specialized communication, as well as in the linguistic description of specific terminologies. There were identified and perfected, in this way, the *paradigmatic and syntagmatic* research methods, taken into consideration from the beginning of the linguistic-descriptive terminology (Cabre 1991:21,25, 27, 37; id. 1998) by describing actual *Romanian terminology* according to a common methodological grid which allowed the identification of features specific to each of them (see Bidu-Vrănceanu 2007; id.2010). There were obtained at the same time, relevant results regarding *the importance of the variation for the widely-used terms*, one of the goals of the *descriptive-linguistic terminology*. Analyses have shown the interdependence of paradigmatic and syntagmatic level, by checking the data in the *dictionaries* against updating terms in *texts with different degrees of specialization* (see Bidu-Vrănceanu 2007; id. 2010.) On the other hand, such analyses have revealed *differences between the languages*, forms of important variation in terminology both at a theoretical and practical level. (see, for example, economic marketing analysis, Bidu-Vrănceanu et al. 2009, 2010 and Museanu 2010, 2011, 2012 for the economic terms).

Variation in terminology is related to a particular orientation of research, increasingly well represented lately, where specialized terms are not considered in isolation, at the level of nomenclatures. The analysis is conducted on their usage in *texts and contexts*, with theoretical and applicative benefits (see, for example, M.P. Jacque 2006: 299, F. Bertaccini and A. Matteucci 2006: 317) as regards *terms* beyond their construal as labels of concepts. The study of "non-linguistic and linguistic contexts" has triggered a progress of terminology (P. Lerat 2006: 89) and has showed that the existence of *textual, discursive variation* is the source of variations of all levels of language (I. Desmet 2006: 236, 238). Such analyses show the existence of differences between a lexicalized form (term) and its usage (F. Neveu 2006: 383), such differences representing illustrative aspects for *terminology variation*.

The *discursive variation*, base of *textual terminology*, has imposed several distinctions of general nature (I. Desmet 2006: 236), some of which seem important for our analysis. The following distinguish: the *specialized scientific level* (texts and academic courses), the level considered as an intermediate one, represented by texts in *specialist magazines* produced by experts for an initiated audience (I. Desmet 2006: 237) (some considering it semi-vulgarized discourse) and the discourse of *scientific vulgarization* represented by specialized fields from the general press (id).

Instances of Economic Terms and the Role of Variation

Our analysis of *economic terms* has grounded its selection based on the terms' *frequency* in the texts from the specialized press and based on their *representativeness* in the conceptual hierarchy of *economics*, as indicated by *strictly specialized texts*.

This analysis will consider *variation* in the corpus compiled for the terms DEFAULT, CRACH, CESSATION of PAYMENTS).

The *selection of texts* is just the premise of research, which should be continued and detailed under a *paradigmatic analysis*, either regarding the expression or how *neology* is involved in the phenomenon of *variation*, or regarding the *content* or variations of the terminological meaning, with consequences over certain semantic relations such as *hyponymy* and *synonymy*.

The *syntagmatic analysis*, based on the study of *contexts*, subject to their integration in certain *types of texts* can reflect the relation between the linguistic system and the conceptual system (M.

Contente 2006: 457). Current studies on terminology (see volume *Mots, termes et contextes*) reveal newer, more refined typologies of *contexts*, summarized by some definitions. In this respect, we can underline the definition directly applicable in our study: “all cognitive, *circumstantial or inter-textual elements* able to intervene in the *process of the meaning’s construction*” (S. Mosbah 2006: 652). This definition highlights both the importance of the *linguistic/extra-linguistic relation*, illustrated in *economic terminology*, and the need for compiling the paradigmatic study with the syntagmatic one in the linguistic analysis of terms.

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The terms DEFAULT, BANKRUPTCY, CRASH or the quasi-synonymic syntagm FAILURE TO PAY could be found in the Romanian economic press as equivalents for *crisis*. There are several examples for each of the above: “*Officials intend to speed up the change of bonds to partially reduce the period of DEFAULT for Greece*” Ziarul Financiar 2011/ 26 July; “*The speech was seen as warning that Germany would not defend the euro forever and comes at a moment when the investors are worried, not knowing if the USA evade the DEFAULT*”, Ziarul Financiar 2011/ 29 July; „... *the voice of an official of its Central Bank stated that the USA “could not go BANKRUPT*”, Capital 2011/ 25 July; „*the crisis of failure to pay moves to the USA*”, id; “*on Friday, the financial assessment agency Fitch announced that would relegate Greece to ‘restricted DEFAULT’, after the leaders of the countries from the euro zone agreed, on Thursday, on a new plan of 109 billion euro aimed at saving Greece from BANKRUPTCY*”, Capital 2011/ 27 July; „*Adrian Vasilescu, advisor of the NBR Governor, has declared today that the global economy is not facing a CRASH, but a severe crisis of debts in the USA, which has expanded worldwide on the financial markets.*”, Capital 2011/ 9 August; „*The symptom restricting the investor from making money on the stock exchange is overrated emotions which make the investor exaggerate, more than usually, the risk of investments on the stock exchange, taking as reference a stock exchange CRASH, whose amplitude was last encountered by investors in the 1930s during the Great Depression from the USA*”, Ziarul Financiar 2011/ 6 July.

In terms of the stock exchange crisis (highly topical in August 2011), we can notice that the term CRAH (crash) is activated (with or without the determinant *stock exchange*). Its use is strictly correlated to other economic terms, even to CRISIS, which appears as hyperonym (and CRAH (crash) as hyponym), being accompanied by a specialized definition: “*Under the current market conditions, a decrease of over 30% on the mature markets can be considered as CRASH (crah)... (it is unlikely) that the decreases of the last weeks (16%) to transform into a CRASH (crah), even if they remind of the crash of 2008*” (Ziarul Financiar 2011/3220); „*Since 1990 there have been six STOCK EXCHANGE CRASHES worldwide*” (id.); “*The STOCK EXCHANGE CRASHES have represented in the last decades the main danger for investors*”, (ibid.). The following contexts are illustrative for the relation between CRAH (crash) and CRISIS; “... *in the following years, we will witness a STOCK EXCHANGE CRASH, even two, maybe... there is a price for the economic growth and the price is these CRISES, which come and will keep coming in the future*” (ibid.); “*We must learn from CRISES and, mostly, to decide, from the start, on a maximum threshold of losses... (for) THE STOCK EXCHANGES CRASHES affecting concomitantly shares on all stock exchanges*” (ibid).

The examples above show the complexity and variety of economic data that determine not only inter-conceptuality, but a large terminological density leading to a greater degree of specialization even in the media of wider circulation.

The relationship between *dictionaries* and *texts*, as well as the importance of *describing the uses of the terms* in the *descriptive linguistic terminology* is based on the interdependence of *paradigmatic and syntagmatic analysis*, with different emphases depending on the issues researched. An example is the *semantic neology* of the terms, involving the interpretation according to theoretical and methodological criteria, with significant variations depending on the examples analyzed. Thus, the preliminary criterion of the *semantic neology* is the new usage of terms in very recent texts (e.g. *absorption* in certain texts of recent years - after 2007 - meaning of "to request, receive, use European funds"), meaning which is not present as such in the dictionaries. When the meaning is present in dictionaries, the variation is considered *semantic shift*. Thus, it results the inter-dependence between the syntagmatic and paradigmatic level, showing that paradigmatic variations occur on the syntagmatic axis, the textual and contextual conditioning resulting in terminological variations (Mejri 2006:545-549; Lino 2006: 512; Eliman 2006:118).

Conclusion

The analyses of the *relationships between specialized vocabulary (SV) and common vocabulary (CV)* refer almost exclusively the *domain of Linguistics*, representing a form of *lexical and semantic dynamics* of great importance (see Bidu-Vrănceanu 1993:63-80; id. 2007: 112-121, 154-155; ibid. 2010:31-113; Stoichițoiu-Ichim 2006:11-17). An increased interest in this respect is motivated extra-linguistically by the *secularization* or *democratization of knowledge* in modern societies today, which determines the assimilation in communication of usual terms, a phenomenon found in various languages (see Bidu-Vrănceanu 2007:29-30;id. 157-162; Meyer and K.Mackintosh 2000: 157-162). Even if the transition of terms in other types of communication than the strictly specialized ones is accompanied by varying degrees *de-terminologisation* (id.), keeping a hard semantic core provides them a specialized meaning when *variation is kept within the limits of a denotative meaning*. Expanding the use of terms in ordinary communication, contextual conditioned, can reach more or less generalized *connotative meanings* (Bidu-Vrănceanu 2007: 157-161).

The *terminological variation* in the current economic texts is primarily conditioned by the evolution of companies, and the economic press of wide circulation is forced to reflect the dynamics of changes, which happen before our eyes, and are not yet reflected in the strictly scientific texts since they develop slower. The strict extra-linguistic determination entails a more rigorous use of the economic terms, with definitions and inter-conceptual relations manifested at the level of the terminological density, which are rather high in texts of wider circulation. These specialized features of the analyzed texts enhance their importance for the specialized economic language, precisely because they reflect the economic dynamics in appropriate terms.

The economic terminology is especially dynamic. Dynamics is seen both in the inventory and the meanings and reflects a close relation between linguistic and extra-linguistic. High frequency of some economic terms does not necessarily ensure their thorough, deep knowledge. The interference of specialized meanings with usual ones represents a difficulty in the exact decoding of terms and makes more important the use of dictionaries.

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THE IMPACT OF THE ACCOUNTING POLICIES ON THE SHARE PRICES OF COMPANIES AND BANKS

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Abstract:

This article concerns the impact of accounting policies on the share price of companies and banks in Poland. The article draws attention to the profit and loss account, which contains an increasing number of records that are not a reflection of actual operations, but for example the valuation of balance sheet items in fair value. Therefore, the result which is calculated on an accrual basis is different from the result calculated on cash basis. The study shows the degree of differences between the results in the profit and loss account and the results in the cash flow statement. It is noted that the degree of differences for banks is lower than in the case of companies. Then the correlation coefficient between changes in stock prices and the gap between the income statement and cash flow statement is calculated. It is shown that the correlation coefficient is very weak.

Key Words: Fair value, profit and loss account, cash flow statement, market value of company

Introduction

The accounting policies have a very big impact on the financial statements. Investors during the decision process are guided by the information which is contained in the financial statements. Recently accounting principles have changed. As a result, fair value was introduced for valuation of the items of balance sheet. The effects of this valuation are reported also in the income statement. In addition, other operations are recognized in profit or loss statement which are not associated with cash flow. As a result, earnings calculated in the profit and loss account (on an accrual basis) differ from the financial results calculated in the cash flow statement (on cash basis).

The study attempts to show how big the differences are and how the share prices change under the influence of these differences. The study was conducted on a group of selected companies and banks operating in Poland. According to the author's knowledge, such studies have not been conducted for the Polish market before.

The paper consists of two parts. The first part will discuss the accounting policies and their impact on the financial statement. The valuation of balance sheet items with using fair value will be presented especially. The second part will be devoted to research in Poland. Methodology of the study, the results and their interpretation will be presented at the end of this paper.

Impact of accounting policies on the information content of financial statements

Profit and loss account, now called the statement of comprehensive income, shows the ability of a company to generate profits. These gains in fact contain transactions with other entities, but not only them. The revenues and expenses that are not related to the actual transactions, but caused by the accounting policies, also have impact on the financial result. The way of recognizing and measuring components of the balance sheet has a very large impact on the ingredients of profit and loss account. The valuation of assets and liabilities has recently become the most controversial, in particular the valuation using the fair value method.

To improve the quality of the valuation balance sheet items, at the beginning of the 1970s American Organization Accounting Principles Board (APB) considered the introduction of an approach based on market valuation for certain financial instruments. Unfortunately, the members of this body did not support this idea. Later, the Financial Accounting Standards Board (FASB) again tried to deal with this problem. However, due to the intervention of the Securities and Exchange Commission (SEC) the project has not been completed on a larger scale. The Federal Reserve System

(Fed), was strongly opposed to the introduction of the method of "mark-to-market accounting". In 1975, only the Statement of Financial Accounting Standards (SFAS) standard nr 12 was issued, which addressed some of the problems associated with the valuation of short-term securities. The concept of "mark-to-market accounting" was introduced to the accounting, along with the speech of R.C. Breeden, the chairman of the SEC on August 10, 1990. During his speech, R.C. Breeden called for the use of market prices in the valuation of financial institutions. This valuation was called as "mark them to market," and later as "mark-to-market accounting".

Fair value is defined both in the U.S. accounting and the International Financial Reporting Standards (IFRS). These definitions differ slightly. According to U.S. standards [SFAS 157] "the fair value is the price that would be received for selling an asset or paid to transfer the liability in a normal transaction between market participants at the measurement date." Fair value is defined by IFRS as "the amount at which an asset could be exchanged, or a liability settled, between well informed, interested and not related parties of transaction."

According to B. Micherda (2006) the introduction of fair value was a response to the information needs of investors, for which the information is presented on the basis of historical cost. In this situation the use of the precautionary principle was not entirely useful.⁸⁹

The idea of fair value seems to be correct. The point is to include the market value of assets and liabilities or other value close to the market in the financial statements. The supporters of this method emphasize that it allows to show the actual value of financial assets. For example, Nick Le Pan, former head of the Organization Financial Institutions, explained that the fair value is only a messenger and should not be criticized for delivering bad news reflecting the weak economic performance.⁹⁰

The opponents of the method "mark-to-market accounting" underline that market values are often unavailable, and their acquisition can be costly. As a result, the financial instruments for which there is no effective market are valued by a company on the basis of assumptions that are reflected expectations of market participants. As a result, the mathematical models are used for valuation of the balance sheet items at fair value. These mathematical models base the calculation on the situation of the market. Opponents also fear that the credibility and verifiability of financial statements are undermined with the introduction of the accounting fair value. The fair value is based on estimates for future cash flows or the market value. As we all know, no one can predict the future, you can only check the validity of hypotheses and estimates the forecasts. For as long as there is no sale transaction, you can not be sure of the price. This uncertain valuation is the opposite of historical valuation, which can be always verified.

Since the introduction of the accounting fair value measurements, scientists are trying to see how investors react to this type of information. Therefore, a study was conducted that focused on the financial results of U.S. companies over the past 20 years. According to these studies it is clear that there is a strong correlation between the price of the shares of listed companies and the fair value of their assets. However, the correlation between the price of shares and the value of its historical assets is much weaker.⁹¹

An interesting study was also conducted by V. Bernard, R. K. Merton and K. Palepu. They take advantage of the fact that for many years the Dutch accounting standards regarding commercial banks were based on the mark-to-market valuation of assets. It turned out that the book value of Dutch banks using the fair value has provided more reliable information for investors than the book value of U.S. banks based in the same time on the historical value. The results are surprising, although the authors indicated that Dutch and U.S. stock market are different enough that they should not be compared with each other.⁹²

It is also worth to recall scandals of the early XXI century, for example Enron. It is good example of consequences of replacing the existing methods of valuation at historical prices by mark-

⁸⁹ B. Micherda, *Problemy wiarygodności sprawozdania finansowego*, Difin, Warszawa 2006, p. 53

⁹⁰ see J. McFarland, J. Partridge, *Mark-to-market' accounting rules fuel debate*. The Globe and Mail – Report on Business, November 20, 2008

⁹¹ see M.E. Barth, W.H. Beaver, W.R. Landsman, *The relevance of the value relevance literature for accounting standard setting: another view*, Journal of Accounting and Economics 31, 2001, p. 77 - 104

⁹² see V. Bernard, R. Merton, K. Palepu, *Mark-to-Market Accounting for Banks and Trifits: Lessons from the Danish Experience*, Journal of Accounting Research 33 (Spring) 1995, p. 1 - 32

to-market valuation and allowing the managers alone at the same time to choose the prices for valuation of the contracts.⁹³

This is confirmed by a recent study. It is clear that the fair value gives more freedom in the measurement of assets and liabilities. It could potentially undermine the credibility of financial statements. For example, Aboody D., M.E. Barth and R. Kasznik found that managers freely choose parameters for option pricing model. These results raise the question whether, in the future, managers will behave similarly, choosing the parameters of the model for measuring the fair value of the other financial instruments.⁹⁴

M. Gmytrasiewicz draws attention to the financial result, which becomes the result only on paper and is based on unrealized income and expenses items. This result can be determined as a function of the increase or decrease in net asset value (often estimated), and this result is not the algebraic sum of the values of real operations. This result does not describe the effects of real economic processes⁹⁵.

Contemporary accounting allow the profit and loss statement to cover more and more items that do not reflect real operations, but are the results of the application of fair value measurement, reserve creation, write-offs, etc. As a consequence, the results calculated on accrual basis in the profit and loss statement differ increasingly from the cash flows presented in the cash flow statement.

Description of studies

Aim of the study

In view of the fact that the financial results from the profit and loss statement are increasingly affected by the operations that are not the result of actual transactions (but e.g. of valuation of the ingredients of balance sheet at fair value, creating reserves, etc.), a question arises how this has an impact on the valuation of a business unit, namely the market value of a company. In other words, it is necessary to analyze the reactions of investors, when they see large differences between the results of the income statement and cash flow statement. Do they, in such a situation, sell off shares of the company fearing that the result calculated on an accrual basis is the result of the operation unreal? Or perhaps the differences between the results of the income statement and cash flow statement are not so important to them?

Thus the aim of the study is to analyze the reaction of investors to the differences between the results of the income statement and cash flow statement. Logic dictates that in such a situation, investors should sell their shares (and the price of shares should fall). The explanation for this behavior of investors may be the fear of creating financial results in isolation from actual operations and the concern of using creative accounting by the entity. Although the financial statements of companies whose shares are traded on the stock exchange are audited, it is not 100% guarantee of the accuracy of the financial statements.

In addition, the study tried to find out whether the reaction of shareholders of the banks is affected stronger by differences between the result of the profit and loss account and cash flow statements. In the case of banks these differences should be larger, because the banks have significantly more assets that can be measured at fair value in their balance sheets.

Method of studies

The study covers the Polish market. Due to the peculiarities of this market, conclusions based on the study should not be regarded as the universal rules.

The data of 20 randomly selected companies and 10 banks whose shares are listed on the Warsaw Stock Exchange were used in the studies. The analysis covers the period from the second quarter of 2001 to the third quarter of 2012. Studies are based on quarterly standalone financial statements provided by Notoria Service S.A.

The number of banks selected for the study is relatively small. This is due to the particular condition of the Polish banking sector. Actually only 15 banks are listed on the Warsaw Stock Exchange. Only 10 banks were chosen among them, because the other banks were involved in mergers and acquisitions during analyzed period. The financial results of the latter, therefore, may not

⁹³ see R. Weil, *After Enron, „mark to market” accounting gets scrutiny*, Wall Street Journal (December 4), 2001

⁹⁴ D. Aboody, M.E. Barth, R. Kasznik, *Firms' voluntary recognition of stock-based compensation expense*. Journal of Accounting Research 42 (2), 2004, p. 123-150

⁹⁵ M. Gmytrasiewicz, *Teoria rachunkowości a Międzynarodowe Standardy Sprawozdawczości Finansowej*, [w:] T. Cebrowska, A. Kowalik, R. Stępień (red), *Rachunkowość wczoraj, dziś, jutro*, SKwP, Warszawa 2007, p. 115

be comparable with the former. Of course, there are more banks on the Polish market, but those are local.

First, the differences between the net financial result (from the profit and loss account) and the sum of net cash flows (from statement of cash flows) were calculated. Since we are interested in differences between these two results, therefore we took into consideration the absolute value. Then this amount was divided by the value of the assets. It could help to make comparisons over time and between different units. For simplicity, let's call this relationship as A. It will be expressed by the following formula:

$$\frac{|net\ financial\ result - sum\ of\ net\ cash\ flows|}{sum\ of\ assets} \quad (A)$$

Then the investors' reactions to the published financial statements were analyzed. For this purpose, the average price of the shares during seven days before the date of publication, and the average share price during seven days after the publication of the financial statements were calculated. Share prices were taken from Internet service of Warsaw Stock Exchange (www.gpw.pl). Then these values were used to determine the rate of change in average share prices.

The findings and conclusions of the study

The correlation coefficient calculated for the chosen companies between the rate of change in average share prices and the relation A is 0.04. The same relation was calculated for banks. The result is 0.0186.

Our results therefore indicate a lack of significant correlation between changes in stock prices and the discrepancies between the results calculated on a cash basis and accrual basis. For the banks, the correlation coefficient is even lower than for the other companies.

The correlation coefficient for the individual company was the highest (0.42) for Prima Moda SA. Table 1 shows the results for the companies that have the highest and the lowest correlation coefficients.

Table 1: The correlation coefficients for selected companies

Short name of the company	Prima Moda	Próchnik	Redan	Indykpol	Wawel
The correlation coefficient between relation A and the change in average prices of shares	0.387841	0.246572	0.048472	0.021152	0.071508

Source: Author's table

Table 2 shows the correlation coefficients for the banks that have the highest and the lowest correlation coefficients

Table 2: The correlation coefficients for selected banks

Short name of the bank	BRE	Kredyt Bank	Handlowy	Pekao	PKO	BPH
The correlation coefficient between relation A and the change in average prices of shares	0.123153	-0.12208	-0.03385	0.050852	0.063464	0.048044

Source: Author's table

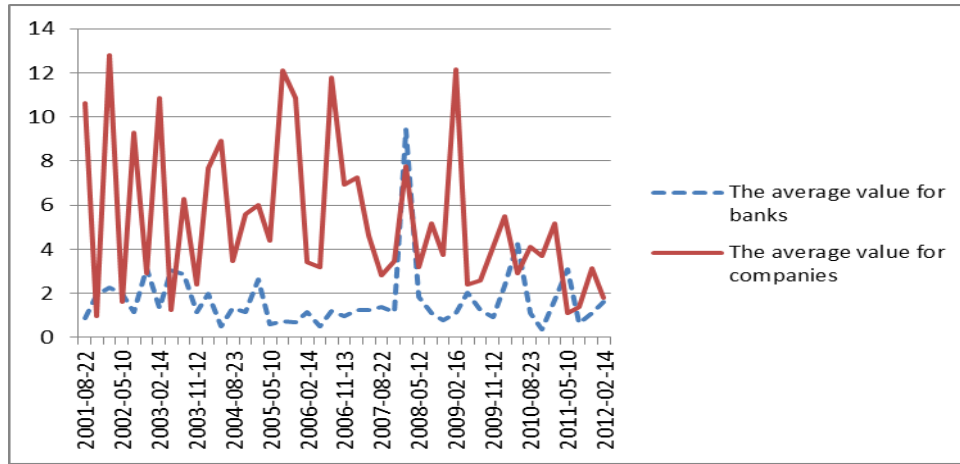
The biggest changes in average share price was recorded in 2008, particularly in the fourth quarter. Regardless of the industry in which the company operated, published reports for the last quarter of 2008 in almost every case marked the decline in stock prices. This was due to the market situation and the fear of the consequences of the financial crisis.

As a result of the studies it has been also noted that the average value of relation A for the banks is much lower than for other companies. The average value of relation A for the banks is 1.699, while the same value for other companies is equal to 5.38. It is very strange, because the banks have in its assets a lot of items which can be measured at fair value. In addition, banks are required to make provisions for bad loans, which are recognized as cost but without any cash flow.

Provisioning was particularly noticeable in 2008. As a result of the financial crisis, the condition of the borrowers has worsened. Then, the relation A reached even the level of 59.36 in one

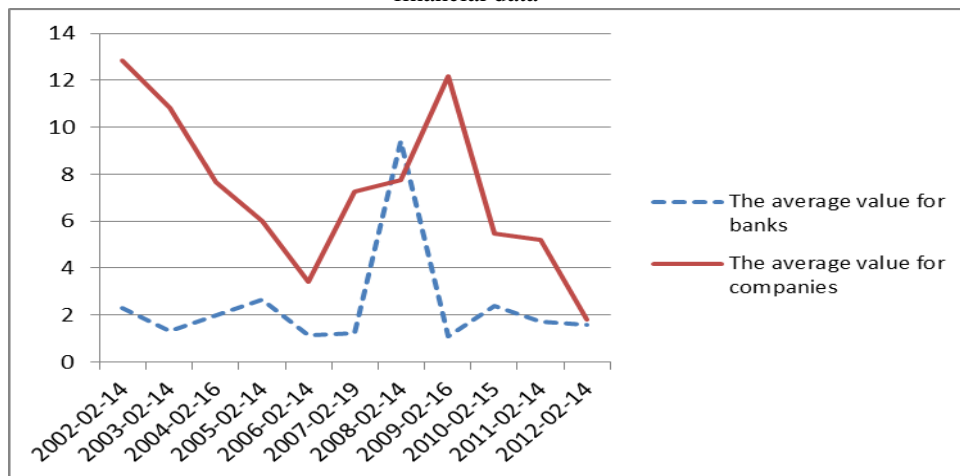
of the banks. However, in general the average indicator A for banks remains relatively low in comparison to the other companies. The average values of relation A for banks and businesses are presented on Figure 1. They were calculated on the base of quarterly data. Therefore, the variation of the ratio is relatively large. However, Figure 2 shows the mean values of relation A calculated for annual data.

Figure 1. An average value of the relation A for selected banks and companies calculated on base of quarterly financial data



Source: Author's figure

Figure 2. An average value of the relation A for selected banks and companies calculated on base of annual financial data



Source: Author's figure

It is clear that the average values of relation A for companies are higher than for banks. This means that companies more often take into account the non-monetary operations in the profit and loss statement.

Conclusion

In consequence, the result of study indicates that investors do not care about the differences between profit calculated on the accrual basis and the cash basis. There is no correlation between the changes in the share prices and the differences between the financial results calculated in the profit and loss account and cash flow statement. Investors do not consider the differences between these results as an attempt to create artificial earnings. In case of such differences they do not sell off shares. It could be argued that investors are aware of the shortcomings of accounting and are able to see them.

Analyzing the relation A, it can be seen that the average value for the companies is much higher than for banks. This means that the companies try to create profit by the non-monetary operations. It is very strange, because banks have more opportunities in this area.

Research is focused on companies and banks operating in the Polish market. The results are drawn from the analysis of selected companies and banks. It may not be appropriate to regard them as universally applicable rule.

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INTERNATIONAL COMPETITIVENESS OF COUNTRIES – EVIDENCE FOR SOME DEVELOPED AND EMERGING ECONOMIES

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Abstract:

This paper identifies and analyzes the international competitiveness of some national economies (developed and developing) by emphasizing similarities and differences between the countries regarding the competitive advantages, on one hand, and the problematic factors for business environment, on the other hand. The experiences of the 11 analyzed countries by this paper (United States, United Kingdom, Germany, France, Japan, Brazil, China, India, Russia, Chile, Mexico) are able to outline some direction that some countries, especially Romania, must follow in order to obtain or increase international competitiveness.

Key Words: National economies, international competitiveness, global competitiveness index, problematic factors

Introduction

The explanation of international competitiveness by economists goes back many years to the theory of comparative advantage and factor pricing stated by Ricardo and Heckscher-Ohlin. Factor-based comparative advantage is an equilibrium concept, predicting a pattern of trade when prices, trade flows and exchange rates are in equilibrium (Adams, Gangnes and Shachmurove 2006, Coldwell 2000).

International competitiveness could be dangerous, obsessive, elusive or meaningless. These adjectives are used by Krugman (1994A, B, 1996) to describe international competitiveness. According to Krugman international competitiveness could result in the wasteful spending of government money supposedly to enhance US competitiveness, could lead to protectionism and trade wars and most important could result in bad public policy on a spectrum of important issues. He consider that the most popular and reasonable definition of competitiveness is “our ability to produce goods and services that meet the test of international competitiveness while our citizen enjoy a standard of living that is both rising an sustainable.” This definition is given by the Council of Economic Advisors.

The issue of national competitiveness is a matter of considerable important to both managers and public policy makers alike (Thompson 2004). In his opinion the notion of national competitiveness is “controversial and has both (1) a narrow, concise conception that relates primarily to cost conditions as determined by exchange rate, and (2) a broader, more nebulous conception that comprises the institutional and systemic circumstances of an economy, such as legal, governmental, public policy and other factors framing countries` wider business environments”.

Aiginger (2006), Kao (2008) and Onsel (2008) define competitiveness as the ability to create welfare, the relative ability of a nation to create and maintain an environment in which enterprises can compete so that the level of prosperity can be improved and suggest also that each comprehensive assessment of competitiveness should contain an outcome evaluation and a process evaluation, on one hand, and must be compared to other nations of similar economic development, on the other hand.

In this context, the aim of macroeconomic policy is very important in order to achieve simultaneous internal and external balance in the short run and of as rapid growths of living standard as possible in the long run (Boltho 1996).

Why some countries are so competitive?

This paper analyze the experience of some countries competitiveness in order to identify similarities and differences between the countries, their competitive advantage and the problematic factors that have an negative impact on international competitiveness.

The analyze take into consideration 12 countries such as: United States, Germany, Japan, United Kingdom, France, Brazil, Russia, India, China, Chile, Mexico and Romania.

In order to analyze the experiences of some countries competitiveness Cho, Moon and Kim (2008) divide countries according to their size and degree of competitiveness as shown in Table 1.

Table 1. Typology of countries groups after size and degree of competitiveness (Adapting of Cho, Moon and Kim, 2008)

Size \ Competitiveness	Small	Medium	Large
Strong	Strong-Small Countries (SSC)	Strong-Medium Countries (SMC)	Strong-Large Countries (SLC) United States, Germany, Japan
Intermediary	Intermediary-Small Countries (ISC)	Intermediary-Medium Countries (IMC) United Kingdom, France, Chile, Romania	Intermediary-Large Countries (ILC) China, India, Brazil, Russia, Mexico
Weak	Weak-Small Countries (WSC)	Weak-Medium Countries (WMC)	Weak-Large Countries (WLC)

The World Economic Forum divides countries in 5 stage of development taking into consideration the level of GDP per capita and the key driven of an economy (Table 2).

Table 2. The pillars of competitiveness and stages of development

Stage of development \ Competitiveness pillars	Factor-driven economies Stage 1	Transition from stage 1 to stage 2	Efficiency-driven economies Stage 2	Transition from stage 2 to stage 3	Innovation-driven economies Stage 3
Basic requirements	60%		40%		20%
Efficiency enhancers	35%		50%		50%
Innovation and sophistication factors	5%		10%		30%
Total (%)	100		100		100
GDP per capita (US\$)	< 2000	2000-3000	3000-9000	9000-17000	> 17000
Countries	India	-	Brazil Chile China Mexico Romania Russia	-	France Germany Japan United Kingdom United States

Table 3. Global Competitiveness Index 2010-2011 (GCI – World Economic Forum)

Country	Overall index GCI		Basic requirements		Efficiency enhancers		Innovation and sophistication factors	
	Score	Rank	Score	Rank	Score	Rank	Score	Rank
United States	5.43	4	5.21	32	5.46	9	5.53	4
Germany	5.39	5	5.89	6	5.11	13	5.51	5
Japan	5.37	6	5.35	26	5.17	11	5.72	1
United Kingdom	5.25	12	5.58	18	5.28	7	4.98	12
France	5.13	15	5.67	16	5.09	15	4.83	16
China	4.84	27	5.27	30	4.63	29	4.13	31
Chile	4.69	30	5.15	37	4.51	35	3.91	44
India	4.33	51	4.30	81	4.42	38	3.96	42
Brazil	4.28	58	4.26	86	4.35	44	4.03	38
Russia	4.24	63	4.52	65	4.19	53	3.36	80
Mexico	4.19	66	4.51	66	4.09	61	3.46	69
Romania	4.16	67	4.36	77	4.18	54	3.24	91

The United States is an innovation-driven economy with a GDP per capita of 46.381 US\$ in 2009. It is on the 4th position on the Global Competitiveness Rank with one of the highest levels of business sophistication and innovation, with the largest market size in the world and with an efficient labor market. Regarding the basic requirements US has some problems with the macroeconomic environment like government budget balance, national saving rate, government debt, and country credit rating.

Germany is an innovation-driven economy with a GDP per capita of 40.875 US\$ in 2009. It is on the 5th position on the Global Competitiveness Rank, on the 2nd position at infrastructure with a very high level of basic requirements and on the 3rd position at business sophistication. Regarding efficiency enhancers Germany has some weaknesses on labor market efficiency such as: lack of wage determination flexibility, inadequate practices for hiring and firing, high rigidity of employment.

Japan is an innovation-driven economy with a GDP per capita of 39.731 US\$ in 2009. It is on the 6th position on the Global Competitiveness Rank but in the first place at the pillars group innovation and sophistication factors. The sources of competitive advantage for Japan are capacity of innovation, company spending on research and development, availability of scientists and engineers, local supplier quality, state of cluster development, production process sophistication, market size, and efficiency of the goods market. The macroeconomic environment (3rd pillar of competitiveness) of Japan is characterized by a high level of government debt and an unbalanced government budget that put Japan on the 105th position with a score of 4.1.

United Kingdom is an innovation-driven economy with a GDP per capita of 35.334 US\$ in 2009. It is on the 12th position on the Global Competitiveness Rank with some competitive advantage that refers to: market size – domestic and foreign, efficiency of labor market, technological readiness, quality of management schools, extent of marketing, quality of scientific research institutions, university-industry collaboration in research and development. Also, there are some problems like macroeconomic environment, government budget balance and government debt.

France is an innovation-driven economy with a GDP per capita of 42.747 US\$ in 2009. It is on the 15th position on the Global Competitiveness Rank. That position is based on the same level of the basic requirements, efficiency enhancers and innovation and sophistication factors. At infrastructure, the 2nd pillar of the global competitiveness index, France is ranked in 4th position having an important competitive advantage. Labor market efficiency is the pillar that has a negative impact on the international competitiveness of France (rank 60). From all the 5 developed countries chosen for the analysis France has the lowest score at business sophistication and innovation.

Brazil is an efficiency-driven economy with a GDP per capita of 8.220 US\$ in 2009, GDP per capita that placed it in stage 2 of development. It is on the 58th position on the Global Competitiveness Rank. The great competitive advantage of Brazil, as other BRIC countries, is the market size, the 10th pillar of the global competitiveness index. Brazil is in a “unique situation in Latin America. While most countries are in search of products through which they can integrate with the global economy, Brazil is innovative in a number of high-tech activities in agriculture, energy,

aircraft, mining products, design, machinery and automobiles, among many others. So, Brazil has competitive advantages from innovation and business sophistication, pillars that are the best ranked in GCI. The country has many possibilities through which it can sustain growth for many years to come” (Havlik P et al, 2009).

Russia is an efficiency-driven economy with a GDP per capita of 8.694 US\$ in 2009, GDP per capita that placed it in stage 2 of development. It is on the 63rd position on the Global Competitiveness Rank. The best rank of Global Competitiveness is obtained by market size followed by infrastructure and higher education and training. Russia has serious problems at goods market efficiency, financial market development, business sophistication and institutions.

According to Havlik P et al (2009) the main challenge for the Russian economy in the medium and long run is whether it will succeed in replacing energy exports as the key growth driver by the development of other sectors (diversification towards manufacturing, high-tech branches, services, etc.), and how it will cope with the acute demographic crisis (the population is projected to decline by nearly 10 million in the coming decade).

India is a factor-driven economy with a very low GDP per capita of 1.031 US\$ in 2009, GDP per capita that placed it in stage 1 of development, stage with an important level of basic requirements. Nevertheless it is on the 51st position on the Global Competitiveness Rank. This position is based on efficiency enhancers like market size, financial market development, business sophistication and innovation. The worst position in Global Competitiveness Rank is taken by the 4th pillar – health and primary education. India has a large, highly diverse and extremely complex economy. Although it remains essentially a poor country, in recent years it has experienced relatively rapid economic growth and become one of the more attractive destinations for foreign investment in the developing world.

China is an efficiency-driven economy with a GDP per capita of 3.678 US\$ in 2009, GDP per capita that placed it in stage 2 of development. It is on the 27th position on the Global Competitiveness Rank. Being the 2nd largest economy in the world (place 2 in market size), China, unlike the other countries that are analyzed, has a competitive advantage from the 3rd pillar – macroeconomic environment (place 4 in GCI).

In brief, the Chinese economy can be characterized as a hybrid economy, combining elements of a developing country, a transition country and a „newly industrializing country” within the institutional and political framework of a „Socialist Market Economy”, which gives the state significant influence on the basically market-driven system (Havlik P et al, 2009).

Chinese products today “meet world specifications and quality requirements. Increasingly, they are also raising their level of technology. The changing nature of inward foreign direct investment points to China’s evolving role as a high-tech producer. As a result, Chinese goods have become more technically sophisticated and have increasingly been accepted in Western markets. Many of these products are made to specifications of developed-country importers. Some goods are produced by subsidiaries of large multinational trademark firms” (Adams, Gangnes, Schachmurove, 2006).

Chile is an efficiency-driven economy with a GDP per capita of 9.525 US\$ in 2009, GDP per capita that placed it in stage 2 of development. It is on the 30th position on the Global Competitiveness Rank. From the 12th pillars of Global Competitiveness Index, 3 pillars are sources of competitive advantage, such as: macroeconomic environment, goods market efficiency and institutions. Chile has also a developed financial market that base on availability of financial services, affordability of financial services, financing through local equity market and soundness of banks (See more in annex 1).

Mexico is an efficiency-driven economy with a GDP per capita of 8.135 US\$ in 2009, GDP per capita that placed it in stage 2 of development. It is on the 66th position on the Global Competitiveness Rank with major advantages offered by the market size and the macroeconomic environment. The pillars institutions, goods market efficiency, labor market efficiency, and financial market development are weaknesses for the Mexico economy in order to become a competitive one (See more in annex 1).

Romania is an efficiency-driven economy with a GDP per capita of 7.542 US\$ in 2009, GDP per capita that placed it in stage 2 of development. It is on the 67th position on the Global Competitiveness Rank. According to Global Competitiveness Report notable competitive advantages

are: at the 2nd pillar Infrastructure – mobile telephone subscriptions; at the 5th pillar Higher education and training – tertiary education enrollment rate and quality of math and science education; at the 6th pillar Goods market efficiency – time required to start a business, prevalence of trade barriers and trade tariffs; at the 9th pillar Technological readiness – broadband internet subscriptions and internet bandwidth; at the 10th pillar Market size – domestic and foreign market size indexes. None of these are better than competitive advantages of other countries taking into consideration in this analysis.

World Economic Forum in Global Competitiveness Report 2010-2011 has published the most problematic factors for doing business in each country. The identification of these factors was made by questionnaire method. From a list of 15 factors, respondents were asked to select the five most problematic factors for doing business in their country – factors that will have a negative impact on the international competitiveness of an economy –and to rank them between 1 (most problematic) and 5.

These factors are:

- Tax regulation
- Tax rates
- Inadequate supply of infrastructure
- Restrictive labor regulations
- Inefficient government bureaucracy
- Corruption
- Access to financing
- Inadequately educated workforce
- Crime and theft
- Foreign currency regulations
- Policy instability
- Poor public health
- Inflation
- Poor work ethic in national labor force
- Government instability/coups

The results for the most problematic factors (up to 10%) are presented in the table 4.

Table 4. The most problematic factors for doing business

Countries/Economies	The most problematic factors
United States	access to financing, inefficient government bureaucracy, tax rates, tax regulation
Germany	tax regulation, restrictive labor regulation, access to financing, tax rates, and inefficient government bureaucracy
Japan	policy instability, tax regulation, tax rates, and inefficient government bureaucracy
United Kingdom	tax rates, access to financing, tax regulation, and inefficient government bureaucracy
France	restrictive labor regulation, tax regulation, access to financing, and tax rates
Brazil	tax regulation, tax rates, inadequate supply of infrastructure, restrictive labor regulations, and inefficient government bureaucracy
China	poor public health, access to financing, policy instability, corruption
India	inadequate supply of infrastructure, corruption, inefficient government bureaucracy, and restrictive labor regulation
Russia	corruption, access to financing, tax regulation, and crime and theft
Chile	restrictive labor regulation, inefficient government bureaucracy, and inadequately educated workforce
Mexico	inefficient government bureaucracy, corruption, access to financing, and crime and theft
Romania	access to financing, inadequate supply of infrastructure, inefficient government bureaucracy, tax regulation, and tax rates

Conclusion

United States, United Kingdom, Japan, Germany, France are countries in stage 3 of development with high level of GDP per capita and with notable competitive advantages based on innovation and sophistication factors such as: local supplier quality, state of cluster development, capacity for innovation, company spending in research and development, university-industry collaboration in research and development. Some of the basic requirement factors for these countries are considered the problematic one like: tax regulation, tax rates, access to financing sources and inefficient government bureaucracy.

From the BRIC countries three of them (Brazil, China, Russia) are in stage 2 of development. India is placed in stage 1 of development. The new Global Competitiveness Report released in September 2011 places Brazil and Russia in the transition stage of development from 2 to 3. The BRIC countries have some similar competitive advantage drive by efficiency enhancers like market size and goods market efficiency. The most problematic factors for BRIC countries in order to increase international competitiveness are other than in developed countries such as: corruption, inadequate supply of infrastructure, crime and theft.

As a conclusion, Brazil is a domestically oriented service economy; Russian economic development is heavily dependent on energy and raw material resources; the Indian economy is essentially service-led, supported by exports; and China's economic development is driven by manufacturing exports and investment. Nevertheless, looking at the more recent policies of the BRICs and their development plans for the future, a certain 'convergence' of strategies across all of them can be observed.

From the analyzed group of emerging economies, Chile and Mexico have improved the global competitiveness scores and ranks in the last years. This improvement was and is based on macroeconomic environment stability with a low level of government debt and an equilibrate government budget balance. Still, there are some problematic factors that must be removing in order to maintain this ascension, such as inefficient government bureaucracy. Unfortunately, according to last Global Competitiveness Report 2011-2012, Romania has lost 10 positions from the last report (currently 77 ranks). This means that Romania has serious problems with almost all pillars of competitiveness from basic requirements to innovation and sophistication factors.

In conclusion, Romania must learn from the experiences of the other countries in order to increase the international competitiveness and must deal with the problematic factors that affect business environment.

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PERFORMANCE EFFICIENCY OF THE JORDANIAN ISLAMIC BANKS USING DATA ENVELOPMENT ANALYSIS AND FINANCIAL RATIOS ANALYSIS

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Abstract:

The purpose of this study is to investigate and compare the development of the relative efficiency of Jordanian Islamic banks performance over time (2005-2009), using two different approaches: Malmquist Data Envelopment Analysis and Financial Ratio Analysis. There are 3 Islamic banks in Jordan, one of which has been established recently, 2010. The results reveal that Jordanian Islamic banks are constantly efficient in term of their inputs producing actual outputs, using both approaches, during the study period. However, the variation between the sample banks is not significant. In addition, there is no significant evidence on the association between DEA and FRA bank rankings. It is recommended that Jordanian Islamic banks managers should increase their banks efficiency by improving recourse utilization to produce optimal outputs.

Key Words: Efficiency, Data Envelopment Analysis (DEA), Financial Ratio Analysis (FRA), Islamic Banks, Jordan

Introduction

Measuring the relative efficiency of financial institutions has gained academic attentions over the years. Various approaches have been used to determine the efficiency. These approaches broadly fall under two types: nonparametric approaches, such as Data Envelopment Analysis (DEA), and parametric approaches, such as Financial Ratios Analysis (FRA).

Islamic banks have started operating in Jordan three decades ago. However, the Jordanian banking system is a non-Islamic one. Currently, there are three Islamic banks. These are Jordan Islamic Bank for Finance and Investment (JIBFI, established in 1978), Islamic international Arab Bank (IIAB, established in 1997) and Jordan Dubai Islamic Bank (JDIB, established in 2010).

Since there have been limited studies investigating Jordanian Islamic banks' efficiency, the objective of this study is to measure and analyze their performance efficiency during the period (2005-2009). As well as to compare between the efficiency level measured by DEA and that calculated by FRA. In other words, this study tries to show how efficient are the Jordanian Islamic banks measured by both DEA and FRA; and to see whether the Islamic banks efficiency level varies by methodology used (DEA and FRA). While most of previous studies adopted conventional tools (FRA) to evaluate the efficiency, this study employs two technical tools (DEA and FRA) to do so. The importance of such analysis is not just to fill the literature gap, but also to help Islamic banks managers find how efficient is their bank performance and how to improve it, and by utilizing which resources. In addition, this study helps investors make an informed decision, as the stock exchange does value and appreciate performance efficiency.

The remainder of this study is organized as follows: Section II reviews the related literature, while section III introduces the subject concepts, including fund resources and uses, financial services, the relationship with the Central bank and the relationship among Islamic banks. Section IV presents the data and the methodology used in the study, and section V reveals the empirical results and the analysis. The last section VI summarizes and concludes the study.

Literature Review

Over the past decade, there has been a considerable growth in studies addressing performance efficiency in the Islamic banking sector, all over the world. Some of the literature used DEA methodology. For example, Viverita et al. (2007) examine the efficiency change of Islamic banks in Africa, Asia and the Middle East during the period of (1998-2002) on country and regional basis, using DEA. The results show that Indonesia and Yemen proved the most improved countries over the period, and Asia was the best region. In contrast, the United Arab Emirates, as a country, and the Middle East, as a region, had the best use of inputs and outputs for efficiency change. For technical change efficiency, Indonesia and Yemen were the most improved countries and Asia is the best performing region. Finally, efficiency and change are negatively related to the banks' age. Similar results founded by Kazaj and Sadeqi (2003), who examine the ability of Islamic banks in financing monetary throughout the world during the period (2000-2001), using DEA. They identified 41 to 46 efficient Islamic banks around the world.

Some literature, however, argues that the country per which the Islamic banks operate is a leading factor of efficiency. Yudistira (2003), for example, provides new evidence on the performance of 18 Islamic banks during the period 1997-2000, and finds that efficiency differences across the sample appear to be mainly determined by country specific factors.

Other literature tries to compare between controlling costs and generating profits efficiencies. Kamaruddin et al. (2008), for instance, investigate this matter in full-fledged Islamic banks and Islamic window operations of domestic and foreign banks in Malaysia during the period (1998-2004), using DEA. They find that Islamic banks are relatively more efficient at controlling costs than at generating profits. The main contributor for cost efficiency of domestic and foreign banks comes from resource management and economies of scale, respectively.

Other literature used FRA. For instance, Bashir (2001) examine the determinants of 14 Islamic banks' performance across eight Middle Eastern countries during the period (1993-1998). The model introduces a set of variables that are expected to affect the performance of Islamic banks. Capital ratios, leverage, overhead, loan and liquidity ratios, and foreign ownership are used as proxies for internal performance, while controlling for macroeconomic environment, financial market structure, and taxation. The results indicate that high leverage and large loans to asset ratios lead to higher profitability. Foreign-owned banks are more profitable than their domestic counterparts. As for the relationship between bank characteristics and performance measures, the results indicate that Islamic banks' profitability measures respond positively to the increases in capital and loan ratios. In addition, customer and short-term funding, non-interest earning assets, and overhead promote bank profits. The results suggest that the tax factors are much more important in the determination of bank performance. The negative effect of the reserve tax indicates the opportunity cost of holding reserves. However, the results should be interpreted cautiously. The scope of the study is limited as several Islamic banks are not included, and the size of the sample is small with many missing observations.

Al-Maghaireh (2005) examines the performance of 3 Islamic banks and 5 non-Islamic banks, in the United Arab Emirates (UAE), in terms of profitability, liquidity, risk and solvency and efficiency in during the period (2000-2004), using FRA. The study shows that the sample Islamic banks are relatively more profitability, less liquid, less risky, and more efficient compared to the UAE commercial banks. Similarly, Samad and Hassan (2000) evaluate the inter-temporal and inter-bank performance of the Bank Islam Malaysia Berhad (BIMB) compared with 8 commercial banks in terms of profitability, liquidity, risk and solvency and community involvement during the period (1984-1997). They apply the financial ratio analysis in measuring the performance, and ANOVA T-test and F-test to determine the significance of the results. The study finds that BIMB is relatively more liquid and less risky. Also, the examination of various performance measures and the inter-temporal comparison of BIMB's performance reveal that Islamic bank made statistically significant progress on returns on assets and returns on equity during the period of the study. Also, BIMB risk increased significantly as measured by debt-equity and equity multiplier. However, the comparison indicates that Islamic bank is still less risky and more solvent.

It can be seen from the above review that, most previous studies investigated the performance of Islamic banks in comparison with the commercial banks, using either DEA or FRA. None of the literature has compared the results of both approaches. This study tries to fill the gap and employs both methodologies, by investigating the performance efficiency of Jordanian Islamic banks, using

DEA and FRA. Also, this study is among the few to investigate the performance efficiency of Islamic banks in Jordan.

Theoretical Framework

Banks have become a necessity for social and economical development. However, bank interest-based activities are prohibited (Haram) in Islam. This led to the establishment of Islamic banks to operate according to Islamic laws and regulations (Sharia). This section introduces the concepts of Islamic banking as well as outlining its main sources and uses of funds.

1) The Concept of Islamic Bank:

An Islamic bank is a financial and monetary institution that provides financial and banking services through its financial intermediary role, i.e. attracts financial resources and employs funds, according to Sharia (Ajlouni, 2012, p.110). Sharia prohibits the payment of interests for the renting of money (Riba), as well as investing in businesses that produce prohibited goods or services, such as Alcoholic drinks or gambling services.

The definition of Islamic bank includes many elements, the most prominent are:

1. Islamic bank is a financial intermediary, like traditional banks.
2. Islamic bank provides financial services, current accounts and investment deposits in accordance with Islamic Sharia.
3. What distinguishes Islamic bank from traditional ones is the Islamic dimension in collecting and using the resources.
4. The Islamic bank aims at developing economic, justice and social solidarity (Obada, 2008, p.27).

Although these principles were used as the basis for carrying out economic activities during the golden middle ages, when Arabic Islamic civilization was bright and prosperous, Islamic banks were formed in the second half of the 20th century. The first Islamic bank in Jordan, Jordanian Islamic Bank for Finance and Investment was established in 1978. Currently there are more than 300 Islamic banks all over the world (Ajlouni, 2012, p.79).

2) Sources of Funds in the Islamic Bank:

As a financial intermediary, an Islamic bank collects deposits and attracts savings as the main resource of fund, in addition to its equity capital. Thus, the sources of funds can be divided in two main parts: the first is self-resources (internal): including the paid in capital of bank, reserves, and retained earnings. The second is external resources, which represent the largest part of the bank resources, i.e. deposits (current, savings and time deposits). Some external funds of Islamic banks include Islamic investment bonds, accounts covering fund, financial guarantees, credit cards, insurance letters, charities, services and grants (Ajlouni, 2012, p.173).

3) Uses of Funds in the Islamic Bank:

Islamic financing is based upon the Islamic Sharia rule that no returns without taking the associated risk (AlGunum BelGurum). Islamic banks use their funds in accordance with this basic rule. This is completely different from traditional banking in that Islamic bank could not lend money for a specific term and gets the reward for that, i.e. interest income. Instead, it provides project funding and shares the returns as well as the project risk. Thus, all Islamic financing types can be seen as different kinds of partnership contracts, as follows (Ajlouni, 2012, p. 205-285):

1- Mosharakah (Joint Venture): It is a contract between the Islamic bank and two or more parties investing in a transaction, for predetermined period of time or assignment. Those parties might be individuals, groups and/or institutions. The distribution of returns, if any, between them is predetermined on an agreed percentage of the returns, regardless of the capital share invested. However, the loss is directly related to the percentage of capital shares.

2- Modarabah (Venture Capital): It is a contract between the Islamic bank (Rabb ElMal), who provides the capital, and an entrepreneur (Rabb ElAmal), who carry-out the work, for predetermined period of time or transaction. The distribution of returns is similar to that of Mosharakah. However, the financial loss will only be burden by Rabbu ElMal, while Rabbu ElAmal loses his efforts, time and reputation.

3- Morabaha (Cost-Plus): It is a contract, used for commodity and trade financing, between a client (business or individual), and the Islamic bank to purchase a certain product, such as a car, a house, or a cargo of sugar. Upon the order of the client, the bank buys the product in a known price and re-sells it to the client with a known cost-plus sale price agreed upon as well as the terms of

payment, i.e. the period of time to pay-back the credit. This sort of Islamic financing has some conditions and terms, such as identifying the product's characteristics, declaring its disadvantages, and knowing the cost of the product and the profit to the bank (Al-Khaqani, 2011, p.237).

4- Sales on Credit & Financing Future Production (Ba'iul Salam): Buying and selling on credit is accepted and apparently widespread in trade transactions. Fiqh books have various details on various aspects of trade transactions on credit. The commodity sold and its price should be known to the seller and buyer, it should have value in law and must be in existence and/or it must be susceptible to delivery of possession, either immediately or at some future time (Ayub, 2007, p.135 and p.139)

Ba'iul Salam is a tool for financing the cost of future production of a manufactured product, an agricultural produce or an imported goods. The manufacturer forwards the cost of future production. The Islamic bank agrees to buy, at an agreed-upon price, the production of the manufactured product (such as machine, equipment, furniture, car or wood) before it is produced. The money is paid in advance to the manufacturer, to use it for financing its working capital (to buy raw materials, pay wages, etc.). This tool helps in providing the liquidity needed by the manufacturers (Ajlouni, 2012, p.257-260).

5- Lease (Ejarah): Ejara is defined by Sharia as a contract to take advantage of renting the right to use an item. The item to be leased must be a non-fungible asset, such as a car or a house; or a work or productive services of an individual, such as an engineer and a builder; or a worker, or any person who can offer defined valuable work. However, gold or silver and food cannot be leased or rented because they cannot be used without being consumed. There are two types of leasing contract in Islamic banks: (1) Lease contract, per which the asset is leased for a specific period of time and then returned to the title holder. (2) Lease-To-Own contract, whereby the user and title owner agree to a monthly payment that consists of two parts. One part has to do with the gradual purchase of the property by the lessee (client), and the other part has to do with the rental of the actual asset at the current market rate. At the end of the period, the asset ownership transferred to the lessee (Abdul-Rahman, 2010, p.56-58).

6- Farming (Mozara'h) and Implanting (Mogharasah): Mozara'h and Mogharasah are methods for financing agriculture. They can be represented by a partnership contract between two or many parties. In the farming partnership, one party presents a farm to another party for cultivation and maintenance in exchange for an agreed share in the crop (Ali, 2010, p.111). In a three party contract, one party will provide the land, second party, the Islamic bank, will provide funds to purchase the inputs (seeds, chemicals, fuel, etc) and the third party will provide the labor, for an agreed share in the crop. Farming contract is a short-term one, a year or less, depending on the term of the crop's season.

The implanting partnership provides financing of tree cultivation. Whereby one party presents a land to another party to plant trees on it. The Islamic bank provides the funds needed for cost of cultivation, wages, and maintenance. These parties share the trees and fruits in accordance to a defined percentage. Implanting contract is a long-term one, more than one year, depending on the durability of the trees.

7- Irrigation (Mosaqah): Mosaqah is a partnership contract on irrigating and gathering fruits of tree. It depends on one party presenting designated plants/trees that produce usable goods to another in order to work on their irrigation in exchange for an agreed share in fruits. This form of financing is very effective for the agriculture sector where a specified share of output will go to the labor and the other portion will go to the owner.

8- Manufacturing (Istisna): Istisna is a contract of manufacturing and is best suited for infrastructure projects in the public sector. It is a special type of sale contract. It is a contract to purchase now, for a predetermined price, something that will be manufactured in the near future according to agreed specifications (Zarqa, 1997). It is a contract in which one party demands the production of a commodity according to certain specifications and then the delivery of it from another party, with payment dates and price specified in the contract. Islamic banks frequently use Istisna to finance construction and manufacturing projects (Hassan and Lewis, 2007, p.53 and p.150). The bank may undertake the construction of a facility for a deferred price, and subcontract the actual construction to a specialized firm. The manufacturer manufactures the asset and delivers it to the bank along with all related assets and market risks (Ayub, 2007, p.77). The mustasne (the Developer) will ask the Banks, as the original sane (Manufacturer), to finance the construction of the Project pursuant

to an istisna agreement. The Banks will act as sane in a parallel istisna agreement with a construction contractor (Hassan and Lewis, 2007, p.220-221).

4) Financial Services in the Islamic Bank:

As long as the service does not imply an interest expense or revenue (Riba), Islamic banks can provide all the sort of banking and financial services provided by any commercial bank. These include, but not limited to, money transfers, collecting commercial documents, selling and buying foreign currencies and renting safe boxes.

5) The Relationship with the Central Bank:

When an Islamic bank operates in a traditional financial and banking system, it has to adhere to the Central Bank regulations. The relationship between the Islamic banks and Central Bank can be summarized as follows (Ajlouni, 2012, p.145):

1. An Islamic bank has to deposit a predetermined percentage of its deposits in the Central Bank (compulsory cash reserve), but has to forgo interest paid by the central bank.
2. Islamic banks cannot deal with the Central Bank as a last resort for lending. Jordanian Islamic banks deposit a stable amount of money in the Central Bank without interest, so that the Central Bank can lend them, when necessary, without interest.
3. Islamic banks cannot buy treasury bills or government bonds, risk-free assets.
4. Islamic banks cannot benefit from the Central Bank offers of interest discount on financing export-oriented projects.

Data and Methodology

The main objective of the study is to examine the efficiency of Islamic banks in Jordan, and the relative efficiency of each bank. The population of the study consists of all Jordanian Islamic banks. According to Central Bank of Jordan website (<http://www.cbj.gov.jo>), there are three Islamic banks operating in Jordan. These are Jordanian Islamic Bank for Finance and Investment (JIBFI) (www.jordanislamicbank.com), Islamic International Arab Bank (IIAB) (www.iiabank.com.jo) and Jordan Dubai Islamic Bank (JDIB). However, (JDIB) is excluded from the study because it has been established recently (2010), while the study sample covers the period (2005-2009), whereby two Islamic banks and twenty one commercial banks operating in Jordan. The data used in this study are financial information, extracted and analyzed from the balance sheets and income statements which are available in the annual reports of the banks.

The study uses eleven financial ratios for bank's performance. These ratios are grouped under three broad categories: Profitability; liquidity and risk and solvency (Samad and Hassan, 2000).

A. Profitability ratios:

- (1) Return on Asset (ROA) = Profit after tax/ total asset
- (2) Return on Equity (ROE) = Profit after tax/ equity capital
- (3) Profit Expense Ratio (PER) = profit/total expense

B. Liquidity measures:

- (4) Cash Deposit Ratio (CDR) = cash/deposit.
- (5) Loan Deposit Ratio (LDR) = Loan/deposit
- (6) Current Ratio (CR) = Current asset (CA) / current liability (CL)
- (7) Current Asset Ratio (CAR) = current asset/total asset

C. Risk and insolvency indicators:

- (8) Debt Equity Ratio (DER) = Debt/equity capital
- (9) Debt to Total Asset Ratio (DTAR) = Debt/total asset
- (10) Equity Multiplier (EM) = total assets/share capital
- (11) Loan to Deposit Ratio (LDR) = loans/deposit

The wide acceptance of Charnes et al. (1978) DEA as a measurement tool for measuring efficiency of the financial institutions (Charnes et al., 1990) can be attributed to certain strengths of this approach. The main advantages of using DEA are due to the fact that the data may not necessarily assume any functional form. DEA leads to a comparison of one decision making unit (DMU) against peer or a combination of peers. The units of the inputs and outputs may vary as they do not affect the calculation of efficiency measure. This implies that changing the units of measurement (e.g., measuring quantity labor in person hours instead of person days) does not change the value of the efficiency measures. It can handle multiple inputs and outputs (Cao et al., 2007). The application of

(DEA) technique has provided several efficiency measures such as allocative, pure technical and scale efficiency that explain cost and profit efficiency differentials among banks (Kamaruddin et al., 2008).

DEA measures the technical efficiency of a given bank by calculating an efficiency ratio equal to a weighted sum of outputs over a weighted sum of inputs (Charnes et al., 1985a). For each DMU, these weights are derived by solving an optimization problem which involves the maximization of the efficiency ratio for that DMU subject to the constraint that the equivalent ratios for every DMU in the set is less than or equal to 1. Therefore, according to DEA, technical efficiency is defined as the ratio of the weighted sum of the m outputs to the weighted sum of the n inputs (Braglia et al., 2003, p. 543).

$$\begin{aligned} \text{Efficiency of DMU } j = E_j &= \frac{\text{weighted sum of outputs}}{\text{weighted sum of inputs}} = \frac{\alpha_1 y_{1j} + \dots + \alpha_m y_{mj}}{\beta_1 x_{1j} + \dots + \beta_n x_{nj}} \\ &= \frac{\sum_{i=1}^m \alpha_i y_{ij}}{\sum_{i=1}^n \beta_i x_{ij}} \end{aligned}$$

Where:

α_k : is the weight of output k

β_k : is the weight of input k

y_{kj} : is the amount of output k from DMU j

x_{kj} : is the amount of input k from DMU j

The efficiency score is usually expressed as a number between 0% and 100% (or constrained to the interval $[0, 1]$). A DMU with a score of 100% is deemed efficient relative to others. A score of less than 100% indicates inefficiency unit. 100% efficiency is attained by any DMU if and only if none of its inputs or outputs can be improved without worsening some of its other inputs or outputs (Charnes et al., 1985b).

Despic et al. (2007) propose a new mathematical model for efficiency analysis, which combines DEA methodology with an old idea—Ratio Analysis. Their model, called DEA-R, treats all possible ratios “output/input” as outputs within the standard DEA model. Although DEA and DEA-R generate different summary measures for efficiency, the two measures are comparable. The mathematical and empirical comparisons establish the validity of DEA-R model in its own right. The key advantage of DEA-R over DEA is that it allows effective integration of the model with experts’ opinions via flexible restrictive conditions on individual “output/input” pairs.

This study follows Johnes et al. (2009) in using the inputs and outputs. The inputs are:

- (1) Deposits and short term funding,
- (2) Fixed assets,
- (3) General and administration expenses,
- (4) Equity.

While, the outputs are:

- (1) Total credit facilities,
- (2) Other earning assets.

The Results and the Analysis:

This section examines Jordanian Islamic banks efficiency in terms of their ability to provide outputs with minimum inputs consumption. The analysis consists of two sections: conventional financial ratio analysis and non-parametric input-output DEA model.

Financial Ratio Analysis:

Liquidity, profitability, and risk and solvency ratios were calculated for the sample banks during the study period (2005-2009). The results are exhibited in table (1).

Table (1) Financial Ratios for Jordanian Islamic Banks
During the Period 2005-2009

Year	Profitability Ratios			Liquidity Ratios				Risk & Solvency Ratios			
	ROA	ROE	PER	CDR	LDR	CR	CAR	DER	DTAR	EM	LDR
Jordanian Islamic Bank for Finance and Investment (JIBFI)											
2005	0.97%	18.86%	52.44%	41.75%	39.63%	0.55	49.72%	1834.21%	94.83%	19.34	39.63%
2006	1.06%	13.42%	60.79%	42.58%	45.46%	1.20	45.54%	1168.45%	92.12%	12.68	45.46%
2007	1.44%	17.22%	79.04%	39.63%	50.77%	1.26	40.28%	1096.99%	91.62%	11.97	50.77%
2008	1.90%	21.83%	83.34%	37.01%	52.63%	0.43	37.30%	1047.78%	91.26%	11.48	52.63%
2009	1.28%	15.77%	69.84%	40.60%	48.85%	0.13	40.19%	1134.21%	91.87%	12.35	48.85%
Mean	1.33%	17.42%	69.09%	40.31%	47.47%	0.71	42.61%	1256.33%	92.34%	13.57	47.47%
Islamic International Arab Bank (IIAB)											
2005	0.97%	6.93%	60.95%	9.28%	54.46%	0.55	43.36%	613.33%	85.98%	7.13	54.46%
2006	1.39%	12.71%	124.51%	17.54%	4.51%	1.20	42.65%	814.86%	89.07%	9.15	4.51%
2007	1.83%	14.67%	103.19%	17.46%	5.96%	1.26	42.30%	701.79%	87.53%	8.02	5.96%
2008	0.86%	8.37%	99.73%	5.55%	68.59%	0.43	36.60%	870.47%	89.70%	9.70	68.59%
2009	0.25%	2.21%	23.45%	5.23%	100.13%	0.13	10.90%	785.01%	88.70%	8.85	100.13%
Mean	1.06%	8.98%	82.37%	11.01%	46.73%	0.71	35.16%	757.09%	88.19%	8.57	46.73%

Table (1) reveals that JIBFI has higher profitability ratios, higher liquidity and higher risk and solvency ratios. In fact, this conclusion is consistent with the finance theory that more risk more return. It seems that the ratio outcomes are influenced by bank size and age. JIBFI is bigger and older than IIAB.

Data Envelopment Analysis:

The Efficiency Measurement System (EMS) software is used to measure the efficiency of the banks included in the sample of the study. In practical terms, the DEA is performed for each year separately. Table (2) displays the DEA results based on the model with two outputs and four inputs.

**Table (2) Jordanian Islamic Banks Efficiency Scores
During the Period 2005-2009**

Year	JIBFI	IIAB	Mean
2005	53.8%	77.2%	65.5%
2006	57.2%	7.4%	32.3%
2007	92.6%	100.0%	96.3%
2008	100.0%	96.9%	98.5%
2009	100.0%	100.0%	100.0%
Mean	80.7%	76.3%	78.5%

It can be seen that JIBFI improved its efficiency score from being inefficient (53.79%, 57.2% and 92.6%) in 2005, 2006 and 2007, respectively to fully efficient (100%) in 2008 and 2009. JIBFI lowest efficiency score was in 2006, resulted from lower bank outputs (total credit facilities). However, IIAB efficiency scores were scattered. It was 77.2% in 2005, higher than that of JIBFI. Then, it decreased significantly in 2006 to a mere 7.4%. Later, it increased sharply to full efficiency in 2007 and 2009. IIAB efficiency scores fluctuation was due to early period of expansion in the bank's number of branches. The efficiency score of JIBFI is significantly higher than IIAB by around 5 percentage points. Overall, efficiency improvement is evident in the Islamic banking industry in Jordan from 65.5% in 2005 to 100% in 2009.

Slack Analysis and Improvement

One of the objectives of this study is to provide suggestions to increase the technical efficiency of Jordanian Islamic banks. This section explains how IIAB and JIBFI can improve their efficiency scores, by employing slacks analysis of inputs and outputs variables of inefficient banks. Slacks are the adjustments of inputs and/or outputs that should be eliminated by the DMU under evaluation to be considered as efficient. Slacks usually refer to inputs and it's the difference between the actual and target inputs and outputs values. Table (3) reports the results of the slack analysis for JIBFI and IIA.

**Table (3) Slacks Analysis for Improving the Efficiency of JIBFI and IIAB
During the Period (2005-2009)**

Year	Inputs				Outputs	
	Deposits & Short Term Funding	Fixed Assets	General and Administration Expenses	Equity	Total Facilities	Other Earning Assets
Slacks JIBFI						
2005	155,646,063	5,638,310	300,457	0	0	944,565
2006	126,289,979	26,628,621	194,374	0	195,661,477	0
2007	119,299,363	30,834,880	415,394	0	375,800,974	0
2008	0	0	0	0	0	0
2009	0	0	0	0	0	0
Slacks IIAB						

2005	66,615,292	0	667,194	18,384,217	0	0
2006	0	4,646,919	51,459	1,328,704	0	0
2007	0	0	0	0	0	0
2008	217,307,189	0	992,776	19,478,687	0	0
2009	0	0	0	0	0	0

Table (3) shows the amount that must be increased in the inputs of IIAB and JIBFI to improve their efficiency scores to produce the actual outputs. As well as the amount of increasing the outputs of IIAB and JIBFI to improve their efficiency scores by utilizing the actual inputs.

Comparison between FRA and DEA:

This section illustrates the result of comparing between the FRA and the DEA. A Spearman's rank correlation analysis of DEA efficiency scores and eleven financial ratios are calculated. Table (4) displays the results.

Table (4) Spearman's Correlations between DEA Rankings and Financial Ratios

Spearman's rho		ROA	ROE	PER	CDR	LDR	CR
Efficiency Rankings	Correlation Coefficient	- 0.200	- 0.200	- 0.600	- 0.800 **	0.900 *	-0.700
	Sig. (2-tailed)	0.747	0.747	0.285	0.104	0.037	0.188
Spearman's rho		CAR	DER	DTAR	EM	LDR	
Efficiency Rankings	Correlation Coefficient	- 0.900 *	-0.500	-0.500	-0.500	- 0.900 *	
	Sig. (2-tailed)	0.037	0.391	0.391	0.391	0.037	

* Correlation is significant at the 0.05 level (2-tailed).

** Correlation is significant at the 0.10 level (2-tailed).

Table (4) shows that bank rankings calculated from DEA efficiency are not significantly related to bank rankings derived only from the ROA, ROE, PER, CR, DER, DTAR and EM ratios. However, significant correlations found in the table above were negative, indicating that there is no evidence of any significant relationship in the rankings derived from any other pairs of DEA efficiencies and financial ratios. The correlation evidence, therefore, suggests that FRA and DEA should generally be viewed as complementary rather than competing, and should be used together when evaluating efficiency of organizations since they answer different questions.

Summary

Growth has been particularly strong in the Jordanian Islamic banking industry, and this led to an increase in product innovation efficiency to deal with higher customer numbers. This study aimed at measuring the technical efficiency of Islamic banks in Jordan. It used the financial information published in the annual reports to measure the efficiency of Jordanian Islamic banks using Data Envelopment Analysis (DEA) and Financial Ratio Analysis (FRA) methodologies, during the period 2005-2009. At the time of the analysis, there were only two Islamic banks listed in Amman Stock Exchange: JIBFI and IIAB.

The FRA results indicate that JIBFI has higher profitability ratios than IIAB, but is more risky than the IIAB. This is consistent with the high risk high returns principle of finance. However, there is no significant difference in the efficiency levels of Jordanian Islamic banks using FRA. Such conclusion is persistent over time. That is, there is no difference in the level of efficiency measured by FRA of JIBFI or IIAB over time.

Technical efficiency of Jordanian Islamic banks was calculated by DEA methodology with Constant Return to Scale model. Statistical tests support similar efficiency hypothesis of FRA that

there is no significant difference in the efficiency levels of Jordanian Islamic banks using DEA. Once again, this result is constant over time. That is there is no difference in the level of efficiency measured by DEA of JIBFI or IIAB over time.

The correlation between efficiency levels measured by DEA and FRA is not statistically significant. Thus, the efficiency of Jordanian Islamic banks must be evaluated by using both DEA and FRA.

Jordanian Islamic banks can improve their efficiency by making some adjustments to its inputs as indicated in this study. Managers of Jordanian Islamic banks should make decisions about reallocating the resources within their banks to increase the efficiency in order to sustain long term growth and profitability. Finally, it would be interesting to assess the efficiency of Jordanian Islamic banks by taking into account other efficiency factors (variables) other than the ones used in this study.

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DETERMINANTS OF COST OF FINANCIAL INTERMEDIATION IN NIGERIA'S PRE-CONSOLIDATED BANKING SECTOR

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Abstract:

In this study we investigated the determinants of cost of financial intermediation (CFI) in some selected quoted banks in Nigeria. The study used thirteen (13) banks which were drawn from the quoted banks in Nigeria. In identifying the determinants of the CFI, we estimated the two popular panel data (fixed and random effects) regression models for six (6) different measures of interest rate spread. In all, our results based on Hausman test selection and some statistical criterion shows that IMED, LLP and OE were the three most common factors that determine the commercial bank interest rate spread in all six models of measuring interest rate spread. This study therefore recommends that financial intermediation (IMED), operating expenses (OE) and Loan loss provision (LLP) be given top priority in understanding the variations in commercial banks' cost of financial intermediation weather measured using narrow or broad interest rate spread definitions.

Key Words: Banking efficiency, cost of financial intermediation, interest rate spread

Introduction

The 1990s were a period of financial reforms within the sub-Saharan Africa (SSA) with dearth of studies on banking efficiency and competitiveness to assess the impact of those reforms. Significant reduction in cost of financial intermediation (CFI) was a core expectation of impact of financial liberalization among developing nations. Studies have shown that freeing interest rates is central to improved efficiency of their financial systems. Interest rate spread (hereafter the spread; and a good measure of CFI) therefore became increasingly the focus of research and policy attention in developing countries. However, Haruna (2011) argued that studies in Latin America, the Caribbean and Africa show that this expectation is not met. He further argued that the lack of convergence of interest rate spreads in developing countries toward those observed in developed countries after financial liberalization may be connected to the rigidity of banks and banking behaviors especially in terms of market power from unchanged operating structures.

Other sources of rigidity may include increased loan provisioning from increased high risk assets' investment in pursuit of larger market share; high non-financial (operating) expenses; and effects of macroeconomic instability or the policy environment. Nonetheless, financial development remains crucial to economic growth in SSA with banks being the most important element of the financial system. Persistence of high spread as a major constraint to economic development should curtailed. To choose the right policies, the Nigerian policy makers need evidence about the key determinants of the spread. The arguments raised by Haruna (2011) are therefore sustained and deepened in this research through an alternate panel data methodological approach to enhance the information content of the research. The main objective of this study therefore, is to evaluate the determinants of the spread in Nigeria. For analytical purposes, the determinants are classified into three broad groups: bank-specific, market/industry-specific and macroeconomic variables. The major contributions from the work are two. Firstly, the spread is defined with a structural consideration that suits the peculiarities of the Nigerian banking practice where increased intermediation costs are hidden through fees and commissions. This becomes more obvious and impacting with a panel data structure instead of time series data set. Secondly, the empirical specification involved decomposing the selected banks' audited financial statements in generating the ex-post spreads used. Ex-post rate being historical generally offer more information than a theoretical ex-ante. The bank characteristics come clear with panel data set.

The rest of the research is organized as follows: section 2 provides a brief literature review and context analysis of the Nigerian banking industry; a brief overview of the panel data methodology choice and the method of analysis are considered in section 3; section 4 presents and discusses the results, and section 5 contains conclusion and recommendations.

Literature review

This section briefly discussed theoretical and empirical propositions regarding interest rate and intermediation costs and concepts of interest rate spreads. Finally it presents the post-liberalization developments in the Nigerian banking system.

Intermediation costs

Banks role as financial intermediaries are very significant in providing the link between the deficit and surplus sectors of the economy. However this is achieved at some cost to both the depositors and borrowers. As such banks’ operating efficiency is quite crucial in ensuring the success of financial liberalization as proposed by financial repression hypothesis proposed by McKinnon-Shaw paradigm.

However, there is no complete agreement on the McKinnon-Shaw paradigm that the removal of financial repression through freeing interest rates and removal of credit ceilings/rationing increase the prospects of economic growth and development. Examples of the proponents of the hypothesis (as cited by Chirwa and Mlachila, 2004) are Khan and Senhadji, 2000; Levine, 1997; King and Levine, 1993; Agarwala, 1983; and Khatkhate, 1988. Whereas Taylor, 1983 and van Wijnbergen, 1983 have argued that high interest rates could be inimical to economic growth by reducing demand for bank credit.

Haruna (2011) among others argued that in spite of this divergence in the literature, the conventional view remains that absence of financial repression can lead to higher growth by enhancing financial intermediation. One measure of banking efficiency is typified by the level of interest rate spreads, the difference between lending and deposit rates. Financial systems in developing countries typically show significantly high and persistent spreads (Barajas and others, 1999; Chirwa and Mlachila, 2004; and Hess, 2007). The expectation is that freeing interest rates and the barriers to entry into the financial system would lead to greater competition and lower profit margins of financial institutions, captured through low interest spreads.

Another point of divergence central to the issue of what constitutes the spread generated varied conceptual definitions. Conceptually, interest margin is different from spread in bank performance analysis. Net interest margin (NIM) is the strict difference between the lending and deposit rates:

$$NIM = L_r - D_r \dots\dots\dots(1)$$

Where L_r = lending rate; D_r = deposit rate.

However, Haruna (2011) argued that payments for services in the intermediation process like loan screening and monitoring, savings processing and management, payment services; and information asymmetry are other relevant costs between the interest rate paid to savers and the interest rate charged to borrowers. Adding these costs as a wedge expressed as $\sum_{i=1}^n(C_i)$ to the interest margin, we arrive at the interest rate spread:

$$IS = L_r - D_r + \sum_{i=1}^n(C_i) \dots\dots\dots(2)$$

Where IS = the spread, $C_i = i^{th}$ cost of services in the intermediation process, n = total number of relevant costs. As such the larger the banking inefficiencies as measured by $\sum_{i=1}^n(C_i)$, the higher the spread will be; and the higher will both be the fall in demand for and the benefits of financial intermediation.

From the perspective of dealership model risk consideration, equation 2 is expressed differently as banks are viewed as risk-averse in both loan and deposit markets. The spread is captured as fees charged for intermediation service on both deposit mobilization and lending:

$$P_L = P + \alpha \dots\dots\dots(3A)$$

$$P_D = P - \beta \dots\dots\dots(3B)$$

Where P is the bank’s opinion of the price of loan or deposit, and (α) and (β) are respective charges for provision of intermediation services. From (3A and 3B) the spread is defined as:

$$IS = (\alpha + \beta) \dots\dots\dots(4)$$

This means $\sum_{i=1}^n(C_i) = (\alpha + \beta)$; and $\sum_{i=1}^n(C_i)$ can therefore be decompose into α and β .

To further measure the true spread as cost of intermediation, one-off and/or revolving fees and commissions are included in some models. Adding these fees and commissions (denoted as f_j) to equation 4, we have:

$$IS = (\alpha + \beta) + \sum_{j=1}^m (f_j) \dots\dots\dots(5)$$

Inclusion of fees and commissions gives the actual full cost to customers in a lending situation, especially in inefficient markets like Nigeria where banks establish processes to circumvent interest rates control. In this regard, Brock and Rojas-Suarez's (2000) narrow and wide definitions of the spread are represented by equations 4 and 5 respectively.

The practice in Nigeria is characterized by equation 5 where the real costs of intermediation are embedded in revolving fees and commissions to achieve two things. Firstly, pay less to depositors by showing commensurate low lending rate. Secondly, due to information asymmetry, the full cost of lending is screened from the regulatory authorities; hence low cost of borrowing statistics will continue to be reported.

Studies on determinants of interest rate spread

The theories of the determinants of commercial banks' interest rate spreads in the literature are classified into three broad categories: bank-specific, industry (market) specific or macroeconomic in nature. Bank-specific characteristics usually include the size of the bank, ownership pattern, loan portfolio quality, capital adequacy, overhead costs, operating expenses, and shares of liquid and fixed assets (Ngugi, 2001; Demirguc-Kunt and Huizinga, 1999; Moore and Graigwell, 2000; Brock and Rojas-Suarez, 2000; Robinson, 2002; Gelos, 2006; Sologoub, 2006; Crowley, 2007; and Folawewo and Tennant, 2008).

The market-specific determinants include level of competition/market power, degree of development of the banking sector, taxes and reserve requirements (Fry, 1995 and Elkayam, 1996). Cho (1988) observed that liberalization theory overlooks endogenous constraints like absence of functioning equity market which are critical to efficient allocation of resources by the banking sector. This impact is very obvious in Nigeria where Banks exhibit market power in both deposit and lending markets. Fry (1995) explained that absence of direct financial markets like the equity and bonds market leads to over reliance on debt finance; this over exposes the financial institutions thereby forcing them to absorb too much risk.

Macroeconomic variables include inflation, growth of output, exchange rates and money market real interest rates. The macroeconomic environment affects the performance of the banking sector to the extent of its influence on the ability of borrowers to timely honor the debt repayment obligation. An unstable macroeconomic environment exhibits a positive correlation between the lending rate and the nonperforming loan portfolio. Cukierman and Hercowitz (1990) attempt to explain the relationship between anticipated inflation and the degree of market power measured as the spread between the deposit and lending rates. They find that when the number of banking firms is oligopolistic, an increase in anticipated inflation leads to an increase in interest rate spread.

The 3 broad classifications are employed in this work. The a priori expectations of both signs and magnitudes are detailed on table 2.

Methodology and data

Average deposit and lending rates published by the CBN are on ex-ante basis. However for meaningful post liberalization analysis, the spread was generated ex-post from the financial statements of the sampled banks. As a variant of Chirwa and Mlachila (2004), we used panel data analysis. This is considered adequate because of the level of heterogeneity of the Nigerian banking firms. Panel data suggests that individuals, firms, states or countries are heterogeneous. This means that panel regression assumed cross section heterogeneity (Cross section fixed effect) and period heterogeneity (Time fixed effect) across the sampled banks. Time-series and cross-section studies not controlling this heterogeneity run the risk of obtaining biased results.

The use of panel data regression methodology in this study is based on three fundamental justifications (1) The data collected had time and cross sectional attributes and this will enable us to study executive compensation over time (time series) as well as across the sampled banks (cross-section) (2) Panel data regression provide better results since it increases sample size and reduces the problem of degree of freedom, more informative data, and more efficiency. (3) The use of panel regression would more variability and avoid the problem of multicollinearity, aggregation bias and

endogeneity problems. (4) Panel data are better able to identify and measure effects that are simply not detectable in pure cross-section or pure time-series data. For instance, individual banking characteristics changes (especially the OGBs) could be missed with non-panel data analysis.

The Panel regression results will be evaluated using individual statistical significance test (t-test) and overall statistical significance test (F-test). The goodness of fit of the model would be tested using the coefficient of determination (R-squared). While the choice between fixed effect and random effect panel estimation method will be based on the Hausman test. In conducting all our data analysis, we will use EViews 7.0 software. To capture different traits of the market, the study further employ a variant of definitions from Chirwa and Mlachila (2004) and composition of the spreads as highlighted below.

Narrow definitions

1. SN1 = NIM = (Interest received – Interest paid)/Loans
2. SN2 = (Interest received/loans) – (Interest paid/deposits); unlike Chirwa and Mlachila (2004) that defined $ISn_2 = (\text{interest received on loans only/loans}) - (\text{interest paid on deposits only/deposits})$. In Nigeria the core of interest paid and received are loan related. As such it is more specific as a measure of loan cost since there may be no significant difference in the two approaches in Nigeria.
3. SN3 = (interest plus commission received/loans) – (interest plus commission paid/deposits);

Broad definitions

With these definitions we are considering loan specific basis using earning assets and interest bearing liabilities in place of total assets and total liabilities, respectively.

4. SW1 = (interest received – interest paid)/total earning assets;
5. SW2 = (interest received/total earning assets) – (interest paid/ interest bearing liabilities);
6. SW3 = (interest plus commission received/total earning assets) – (interest plus commission paid/ interest bearing liabilities); this variable is aimed to account for service charge remissions.
7. SBW = average prime lending rate - average deposit rate. The seventh is a bench-mark spread that is directly calculated from the published average deposits and savings rates against both prime and maximum lending rates.

Population and sampling

At the time bank consolidation commenced in 2005, there were 24 banks in Nigeria classified as either “New Generation” (NGB) or “Old Generation” (OGB) based on their age and level of efficiency. Perception of efficiency levels between the OGB and the NGB are different. As such in order to avoid sample concentration or bias, 13 sample points taken were stratified into 6 NGB⁹⁶ and 6 OGB⁹⁷ with FSB International (the thirteenth) as their hybrid⁹⁸.

Model specification

Most models of the determinants of bank interest rate spreads are often based on the framework of a bank as a profit- or wealth-maximizing firm; that is seeking to maximize profits defined by a feasible set of assets and liabilities whose per unit prices and costs are set by the bank. This approach views banks as risk-adverse dealers in both the loan and deposit markets where loan requests and deposit generation are at random and unsynchronized. Thus by incorporating various aspects of the competitive process and scale economies, these models provide the basis for the empirical testing of the spread in a manner consistent with the Structure Conduct Performance (S-C-P) and efficient market hypotheses.

The panel regression with an error term (ε_t) and cross-section effect (wt) for the six categories of interest spread measurement are expressed in equation (1) to (2);

Model 1: NIM = (Interest received – Interest paid)/Loans

$$NIM_{it} = \alpha_0 + \beta_1 LLP_{it} + \beta_2 OE_{it} + \beta_3 IMED_{it} + \beta_4 LR_{it} + \beta_5 SHN_{it} + \beta_6 ERD_{it} + \beta_7 TBR_{it} + \beta_8 IFL_{it} + w_i + \varepsilon_{it}$$

Model 2: (Interest received/loans) – (Interest paid/deposits);

⁹⁶ Access Bank, Diamond Bank, GTBank, Zenith Bank, Intercontinental and Oceanic Bank

⁹⁷ First Bank, Union Bank, UBA, Afribank, WEMA, and Inland Bank (now First Inland).

⁹⁸ Federal Savings Bank was an old establishment and a fringe player that assumed a full modern commercial bank role after liberalization.

$$SN2_{it} = \alpha_1 + \partial_1 LLP_{it} + \partial_2 OE_{it} + \partial_3 IMED_{it} + \partial_4 LR_{it} + \partial_5 SHN_{it} + \partial_6 ERD_{it} + \partial_7 TBR_{it} + \partial_8 IFL_{it} + w_i + \varepsilon_{it}$$

Model 3: (interest plus commission received/loans) – (interest plus commission paid/deposits)

$$SN3_{it} = \alpha_3 + \eta_1 LLP_{it} + \eta_2 OE_{it} + \eta_3 IMED_{it} + \eta_4 LR_{it} + \eta_5 SHN_{it} + \eta_6 ERD_{it} + \eta_7 TBR_{it} + \eta_8 IFL_{it} + w_i + \varepsilon_{it}$$

Model4: (interest received – interest paid)/total earning assets;

$$SW1_{it} = \alpha_4 + \phi_1 LLP_{it} + \phi_2 OE_{it} + \phi_3 IMED_{it} + \phi_4 LR_{it} + \phi_5 SHN_{it} + \phi_6 ERD_{it} + \phi_7 TBR_{it} + \phi_8 IFL_{it} + w_i + \varepsilon_{it}$$

Model 5: (interest received/total earning assets) – (interest paid/ interest bearing liabilities);

$$SW2_{it} = \alpha_5 + \pi_1 LLP_{it} + \pi_2 OE_{it} + \pi_3 IMED_{it} + \pi_4 LR_{it} + \pi_5 SHN_{it} + \pi_6 ERD_{it} + \pi_7 TBR_{it} + \pi_8 IFL_{it} + w_i + \varepsilon_{it}$$

Model 6: (interest plus commission received/total earning assets) – (interest plus commission paid/ interest bearing liabilities);

$$SW3_{it} = \alpha_6 + \theta_1 LLP_{it} + \theta_2 OE_{it} + \theta_3 IMED_{it} + \theta_4 LR_{it} + \theta_5 SHN_{it} + \theta_6 ERD_{it} + \theta_7 TBR_{it} + \theta_8 IFL_{it} + w_i + \varepsilon_{it}$$

Where

α_i = intercept

ω_i = Variables that vary across banks but do not vary over time

ε_{it} = error terms over cross section and time

Unlike Enendu (2003) who analyzed ex-ante commercial bank spreads in Nigeria, this study looked at ex-post spread which is likely to be more relevant given the incongruity between the state of the Nigerian real sectors and the independent growth of the banking sector. Following Beck and Fuchs (2004) and Hesse (2007), an accounting decomposition of the spread was conducted first to generate the ex-post spreads before the econometric analysis. In the model, it is hypothesized that the spread is a function of the three (3) broad classifications of the determinants tabulated in table 2 below.

Table 2: Definition of Determinants

Classifications	Variables	Definitions	Significance/A Priori Expectations
Firm-Specific	Operating Expenses (OE)	Non-interest Exp/ Total Earning Assets	Requires more spread to cover. It is expected to have direct effect on Spread.
	Loan Loss Provisions (LLP)	Provision for bad debt/Total loans & Advances	Banks would tend to push this cost to customers. In ex-post analysis, LLP on the income statement decreases spread. Hence inverse relationship is anticipated.
Market-Specific	Financial Intermediation (IMED)	Total Loans/Total Deposit Liabilities	Active intermediation indicates high IMED. Competitive environment decreases spread; hence an inverse relationship.
	Shareholders' Networth (SHN)	Shareholders' Funds/ Total Assets	Requires more spread to accumulate. It is expected to have a positive relationship with Spread.
Macroeconomic	Exchange Rate Depreciation (ERD)	$[(fxr)_t - (fxr)_{t-1}] / (fxr)_{t-1}$ where (fxr) = periodic exchange rate and $t-1$ = annual time-lag.	Proxied by its annual average rate of growth/depreciation. It is expected to have direct effect on Spread.
	Treasury Bill (TRB)	Average Annual Treasury Bill rates	Proxy for marginal cost of funds; a bench mark for interest rate decisions by banks. As a cost

		indicator, it should generate a positive relationship with spread.
	Annual Inflation Rate (IFL)	$[(CPI)_t - (CPI)_{t-1}] / (CPI)_{t-1}$ where $t-1$ = annual time-lag.
		This is to capture business cycle effects. Inflation can also affect spread if monetary shocks are not passed wholly to deposits and lending rates, or adjustment occurs at different speed and time.

Regression results

This study adopted the two widely panel data regression models (fixed effect and random effect panel data estimation techniques). The difference in these models is based on the assumptions made about the explanatory variables and cross sectional error term.

	LLP	OE	IMED	LR	SHN	ERD	TBR	IFL	Adj-R2	F-stat	Hausman test
NIM FIXED EFFECT MODEL	0.05 (-2.4) [0.01]	0.45 (6.8) [0.0]	-0.04 (-3.2) [0.0]	-0.01 (-0.3) [0.76]	0.02 (1.1) [0.29]	-0.05 (-0.8) [0.41]	(0.11) (2.1) [0.04]	-0.03 (-1.2) [0.24]	0.54	7.07	19.67 [0.01]
SN2 RANDOM EFFECT MODEL	0.20 (3.2) [0.0]	0.32 (1.5) [0.1]	-0.33 (-6.6) [0.0]	0.14 (0.8) [0.45]	0.01 (0.1) [0.92]	0.89 (2.6) [0.01]	-0.18 (-0.5) [0.61]	0.19 (1.4) [0.16]	0.50	16.71	13.09 [0.11]
SN3 FIXED EFFECT MODEL	0.34 (2.6) [0.01]	1.73 (4.1) [0.0]	-0.33 (-3.7) [0.0]	0.21 (1.0) [0.34]	-0.11 (-1.1) [0.28]	0.45 (1.1) [0.3]	-0.12 (-0.31) [0.75]	0.25 (1.36) [0.18]	0.29	7.38	5.35 [0.72]
SW1 RANDOM EFFECT MODEL	0.00 (0.3) [0.76]	0.13 (2.8) [0.01]	-0.04 (-4.2) [0.0]	-0.01 (-0.4) [0.7]	-0.03 (-2.8) [0.0]	0.02 (0.4) [0.71]	0.09 (1.3) [0.21]	-0.03 (-1.1) [0.26]	0.29	7.38	5.35 [0.7]
SW2 FIXED EFFECT MODEL	0.09 (3.2) [0.0]	-0.48 (-5.4) [0.0]	0.18 (9.4) [0.0]	-0.01 (-0.2) [0.8]	-0.04 (-1.8) [0.08]	0.14 (1.6) [0.11]	-0.13 (-1.7) [0.09]	0.34 (3.6) [0.0]	0.68	12.37	30.07 [0.0]
SW3 RANDOM EFFECT MODEL	0.04 (-1.8) [0.08]	0.93 (10.5) [0.0]	-0.12 (-5.9) [0.0]	0.04 (0.6) [0.56]	0.01 (0.5) [0.62]	-0.02 (-0.2) [0.84]	0.03 (0.2) [0.8]	-0.03 (-0.7) [0.48]	0.57	22.16	8.53 [0.4]

Note: (1) Parentheses () are t-statistic while brackets [] are p-values

In table 3, we presented the two panel data estimation techniques (fixed effect and random effect) for the six model based on Hausman test selection. The six results are briefly discussed as follows:

(1) **NIM model**, shows that about 53% of the systematic variations in interest rate spread in the selected Nigerian banks was explained jointly by firm, market and macroeconomic specific factors. Specifically, we observed that **LLP**, **OE**, **IMED** and **TBR** were the key determinants of NIM

measure of interest rate spread in the selected banks in Nigeria. The F-statistic of the NIM model shows that the model was statistically significant at 1% levels and the Hausman test selected fixed effect panel data estimation as more appropriate when compared to the random effect approach.

(2) **SN2 model** shows that about 50% of the systematic variations in interest rate spread in the selected Nigerian banks was explained jointly by firm, market and macroeconomic specific factors. On the basis of coefficients and p-values, we observed that **LLP**, **IMED** and **ERD** were the key determinants of SN2 measure of interest rate spread in the selected banks in Nigeria. The F-statistic of the SN2 model shows that the model was statistically significant at 1% levels and the Hausman test selected random effect panel data estimation as more appropriate for estimating SN2 interest rate spread.

(3) **SN3 model**, shows that about 61% of the systematic variations in interest rate spread in the selected Nigerian banks was explained jointly by firm, market and macroeconomic specific factors. The Hausman test shows that SN3 model of interest rate spread is best estimated using a fixed effect panel technique and on the basis of coefficients and p-values, we observed that **LLP**, **OE** and **IMED** were the key determinants of SN3 measure of interest rate spread in the selected banks in Nigeria. The F-statistic of the SN3 model shows that the model was statistically significant at 1% levels

(4) **SW1 model**, shows that about 28% of the systematic variations in interest rate spread in the selected Nigerian banks was explained jointly by firm, market and macroeconomic specific factors. Specifically, we observed that **OE**, **IMED** and **SHN** were the key determinants of SW1 Measure of interest rate spread in the selected banks in Nigeria. The F-statistic of the SW1 model shows that the model was statistically significant at 1% levels and the Hausman test selected random effect panel data estimation as more appropriate when compared to the fixed effect approach.

(5) **SW2 model**, shows that about 69% of the systematic variations in interest rate spread in the selected Nigerian banks was explained jointly by firm, market and macroeconomic specific factors. On the basis of coefficients and p-values, we observed that **LLP**, **OE**, **IMED**, **SHN** and **TBR** were the key determinants of SW2 measure of interest rate spread in the selected banks in Nigeria. The F-statistic of the SW2 model shows that the model was statistically significant at 1% levels and the Hausman test selected fixed effect panel data estimation as more appropriate for estimating SW2 measure of interest rate spread.

(6) **SW3 Model**, shows that about 57% of the systematic variations in interest rate spread in the selected Nigerian banks was explained jointly by firm, market and macroeconomic specific factors. The Hausman test shows that SW3 model of interest rate spread is best estimated using a random effect panel technique and on the basis of coefficients and p-values, we observed that **LLP**, **OE** and **IMED** were the key determinants of SW3 measure of interest rate spread in the selected banks in Nigeria. The F-statistic of the SN3 model shows that the model was statistically significant at 1% levels.

Following the above, in identifying the determinants of interest rate spread in Nigeria commercial banks from the six models of interest rate spread measurement we observed that **IMED**, **LLP** and **OE** were the three most common factors that determine the commercial bank interest rate spread in all six models of measuring interest rate spread. This therefore means that market specific factor (financial intermediation (**IMED**)) and firm specific factors (operating expenses (**OE**) and Loan loss provision (**LLP**)) are most relevant in understanding the variations in commercial banks interest rate spread in Nigeria weather measured using narrow or broad approach.

Conclusion and recommendations

Studies of bank interest rate spreads have generally relied on the net interest margin as the measure of the cost of intermediation. However the availability of more disaggregated data through the banks' income statements has recently allowed researchers to explore other forms of spreads. In the same manner, in this study the net interest margins (*NIMs*) and other spreads are calculated from the selected banks' balance sheet and income statements.

Thus in investigating the determinants of interest rate spread in commercial banks in Nigeria, the study used thirteen (13) banks drawn from the quoted banks on the Nigerian Stock Exchange. In identifying the determinants of the interest rate spreads, we estimated the two popular panel data regression models (fixed and random effects) for six (6) different measures of interest rate spread. In all, our results based on Hausman test selection and some statistical criterion shows that **IMED**, **LLP**

and OE were the three most common factors that determine the commercial bank interest rate spread in all the six models. This study therefore recommends that financial intermediation (IMED), operating expenses (OE) and Loan loss provision (LLP) be given top priority in understanding the variations in commercial banks interest rate spread.

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OUTSOURCING STRATEGY AND ORGANIZATIONAL PERFORMANCE: EMPIRICAL EVIDENCE FROM NIGERIA MANUFACTURING SECTOR

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Abstract

Globalization of practices driven by accelerated competition among manufacturing and service delivery organizations has pushed firms to create value for money through efficient use of limited resources. Outsourcing is one of the management tools that are gaining currency among managers in addressing the new dynamic business order. This study examined the axiomatic relationship between outsourcing strategy and organizational performance in Nigeria manufacturing sector. The study adopted a stratified sampling technique to arrive at 120 sample elements for the study. Some of the top and middle level managers of Cadbury Nigeria Plc and Nestle Foods Plc were interviewed to further elicit information on the key variables. Copies of the questionnaire were administered and the data obtained were analyzed using Regression analysis. The questionnaire for this study was subjected to test- re-test reliability assessment. Opinions and observations of experts and professionals were incorporated into scale questions in order to ensure the content validity. The findings reveal that firms that outsource experience reduce average cost, increased sales turnover and profitability, enhance expertise, improve service quality, reduce staff strength, streamline the production process, reduced administrative burden and save time for core activities. It was recommended that companies that outsource should continue to monitor the contractor's activities in order to ensure compliance with best practices. Workers should be made to embrace the strategy before implementation so as to alley the fear of loss of Jobs.

Key Words: Outsourcing strategy, organizational performance and core competence

Introduction and statement of research problem

Outsourcing is the process of replacement of in-house provided activities by subcontracting it out to external agents. Consequently, the management and development of innovations in outsourced activities become the responsibility of an agent external to the firm.

Outsourcing avails organizations the opportunity to concentrate her core competencies on definable preeminence business area and provide a unique value for customers (Behara, Gundersen, & Capozzoli, 1995). The goals of outsourcing are strategic: improved efficiencies, lower costs, improved flexibility, higher quality, and a greater ability to achieve a competitive advantage.

The ultimate strategic goal is to develop core competencies that will strengthen barriers of entry for new firms to survive. By focusing on core competencies and utilizing qualified vendors to provide process that are not one of the organization's core competencies, such that the organization's risk can be minimized and shared with its suppliers.

Core competencies are the collective institutional learning capabilities of the company that allow it to supply products and services that uniquely add absolute preeminence in those competencies (Hilmer & Quinn, 1994). "Core competencies are the innovative combinations of knowledge, special skills, proprietary technologies, information, and unique operating methods that provide the product or the service that the customer value and want to buy" (Greaver, 1999)

When outsourcing decisions are made on the basis of an in-depth understanding of the organization's core competencies, and are intended to build or enhance the organization's competitive advantages, outsourcing becomes strategic (Bettis, Bradley, & Hamel, 1992).

Firms' decision on outsourcing is usually analysed as a "make or buy" dilemma. On one hand, market imperfections, such as measurement problems, difficulties to control the collaboration between the customers and the provider, reduction in control over how certain services are delivered and increased complexity in arms-length contracts may in turn raise the company's liability exposure. The "make" option is favoured, in the case of services that hinder the comparability of output and prices and reduces market transparency. Further, asymmetric information generates adverse selection and moral hazard problems, emphasizing the role played by reputation (De Bandt, 1996). On the other hand, there are other arguments that favour the "buy" option. Among them are cost cut, increased capacity, improve quality, increase profitability and productivity, improve financial performance, lower innovation costs, risks, and improved organizational competitiveness, are very commonly considered as the main reasons to justify outsourcing strategies. All of these inconclusive arguments necessitate the need for this study.

Literature review

Dwindling resources and market competitiveness have forced organizations to scrutinize their methods of producing goods and services and make changes in their processes in order to maximize economic returns. To be able to survive and be profitable in current globalization era, organizations have pursued continuous improvement, leaned up production, reengineered business processes, and integrated supply chains (Brannemo, 2006). Over the past decades there is a growing realization of the important contribution of sourcing strategy on organizational performance (Cousins et al., 2006).

Outsourcing is a management strategy by which an organization delegates major, non-core functions to specialized and efficient service providers. According to Corbett (1999) outsourcing is nothing less than the wholistic restructuring of corporations around core competencies and outside relationships.

Yankelovich (2003) indicated that two-third of companies world-wide outsource at least one business process to an external third party. This practice appears to be most common in the U.S., Canada, and Australia, where 72 percent of outsourcing is being sought. Javaligi (1998) noted that successful implementation of an outsourcing strategy has been credited with helping to cut cost increase capacity, improve capacity and improve quality.

Kotabe (1998) argued that there could be negative long-term consequences of outsourcing resulting from a company's dependence on independent suppliers. Such reliance on outsourcing may make it inherently difficult for the company to sustain its long-term competitive advantage without engaging in the developmental activities of the constantly evolving design and engineering technologies. This view point was corroborated by Corley (2000) when he examined the outcomes of technology-sourcing partnerships from the sourcing firms' point of view and found out that, equity-based alliances were more effective than contract-based outsourcing.

Steensma, Kevin and Corley (2000) suggest that the outcomes from technology partnerships for sourcing firms depend on the interaction between technology attributes and the interdependence between source and sourcing firms.

Klaas et al (2001), suggest that the influence of organizational characteristics is highly contingent, suggesting that organizational characteristics have different effects on various types of outsourcing activities outsourced. As such, it appears that many factors such as pay level, promotional opportunities and demand uncertainty should be considered when deciding to outsource functions or activities.

Kotabe (1998) identifies three types of performance measures as necessary components in any outsourcing performance measurement system: strategic measures; financial measures; and quality measures. Malhorta (1997) used additional dimensions of market performance such as costs savings, cycle time, customer satisfaction, and productivity to measure the effectiveness of outsourcing strategy.

Foster (1999) argue from a different perspective, obstacles such as poor choices of sourcing partners, inadequate planning and training/skills needed to manage outsourcing activities and poor organizational communication have also been identified as key determinant of the success of outsourcing projects .

Lau and Hurley (1997) examined the relationship between outsourcing and profitability margin and they found that Chrysler's profit margin is four times as high as that of GM due to effective outsourcing strategy. Frayer, Scannell, and Thomas (2000) suggest that companies are

increasingly viewing outsourcing strategies as a means of reducing costs, increasing quality, and enhancing a firm's overall competitive position.

According to Ellram et al. (2007), outsourcing has implications for day-to-day management and performance, as well as strategic implications. Therefore, companies must outsource intelligently.

Outsourcing decisions may affect company's cost structures, long-term competitive situation and can also alter the nature of risks that the company must manage (Brannemo, 2006). Hence, it is crucial for management to understand and have a clear conceptual framework of their outsourcing decision. Furthermore, it will also important that company must know the benefits and risks of outsourcing. The increasing use of outsourcing arrangements, as well as the unfamiliar complexity associated with it especially in developing countries suggests the need to probe further about how to effectively utilize this strategy.

Research hypotheses

The primary intent of the study is to examine the conjectural statement that outsourcing strategy as an independent variable has an influence on performance variables depicted by sales turnover, profitability and customer satisfaction.

Specifically the hypotheses are:

H₀: Outsourcing Strategy has no significant effect on sales turnover.

H₀: Outsourcing Strategy has no significant influence on profitability.

H₀: Outsourcing Strategy has no significant effect on Customer Satisfaction.

Operationalization and measurement of variables

- a. **Outsourcing Strategy:** this was measured by the extent of the production activities that were subcontracted to other firms in the same industry group.
- b. **Customer Satisfaction:** this was measured in terms of the number of complaints/and its customer repurchase patronage.
- c. **Performance:** sales growth gotten from the records of the organization and profitability index were used to measure performance.
- d. **Core Competence:** this was operationalized as the quality of organization's human and material resources devoted to the portion of her production process that is retained in-house and is considered very critical to her performance.

Population of the study, sample size

The purpose of this study is to examine the effects of outsourcing strategy on organizational performance using data from manufacturing firms in Nigeria. A survey research design was used. The justification for the use of survey research for this study according to Asika (2004) is that convenience with which the survey can be conducted and inferences for larger population can be made from the result. The target population for this study consisted of all beverage manufacturing firms in Nigeria. Two leading firms in the beverage manufacturing industry were used as survey for the study. The choice of these two large firms in the industry was borne out of the fact that they are the leading adopters of prospectors strategy in the industry. The staff strength of the firms (Cadbury Nigeria Plc., and Nestle Food Plc.) are 937 and 1464 respectively.

A five likert scale was used to seek information from top, middle and lower level managers of the firms on the wide range of key measurement variables of the study.

Out of the total staff strength of 2401, stratified sampling techniques was used to administer 120 questionnaires on top, middle and lower level managers of the organizations. Some other lower members of the marketing and production departments were equally interviewed in order to further elicit information about the feelings of the customers in terms of customer desires and satisfactions. Out of 120 questionnaires distributed, only 93 were dully filled and returned.

In the words of Asika (2004) a sample is a subset of a universe or a part of a study population that is systematically selected to represent the population. The decision to use stratified sampling technique to pick the respondents is based on the fact that the decision to outsource often times is taken by the top management. Middle and lower level managers were included because they have direct contact with the production floor men and customers who are the final end of the production and distribution channel. More so, this technique of sample selection is particularly necessary when one want to apply research finding directly to a population (Mook, 1983).

Model specification

Perf. = f(OUTS.)

.....(i)

Where:

Perf = performance

OUTS. = outsourcing

Performance = sales turnover, profitability and customer satisfaction

Outsourcing = the quantum of production activities subcontracted out to other firms in the group industry. Explicitly, it's the fraction of the total cost of a project handled by a large firm that is paid to other firms for service rendered.

Outsourcing = f(% of project cost paid to other firms)(ii)

Data analysis and results

Regression analysis techniques were used for data analysis. Regression analysis was used to determine the degree of influence in the dependent variables (sales turnover, profitability and customer satisfaction) which can be associated with changes in the value of independent or predictor variable holding on other variables constant. To further examine the trend of the relationship among these variables of the study, (SPSS) Statistical Package for Social Scientist was equally used to analyze the data.

A mean index of performance variable was adopted to summarize the data. This is shown in table 1 below.

Table 1: Mean index of corporate performance.

Descriptive Statistics

Performance indicators	N	Minimum	Maximum	Mean	Std. Deviation
Sales turnover	93	1	5	4.09	1.129
Profitability	93	1	5	4.26	.966
Customer Satisfaction	93	1	5	4.16	.947
Valid N (listwise)	93				

Regression Analysis for Research Hypothesis 1

H₀: Outsourcing has no significant effect on sales turnover.

Table 2.

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.850 ^a	.722	.719	.599

a. Predictors: (Constant), Outsourcing strategy

Table 3.

ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	84.669	1	84.669	236.034	.000 ^a
	Residual	32.643	91	.359		
	Total	117.312	92			

a. Predictors: (Constant), Outsourcing strategy

b. Dependent Variable: Sales turnover

Table 2 shows a coefficient r of 0.850 (85%) which indicate that there exist a linear direct relationship between outsourcing and sales turnover. A coefficient of determination r² of 0.722(72.2%) reveals that outsourcing accounts for 72.2% of the organizations' sales turnover and Table 3 also shows that the analysis of variance for linear regression data produced F-ratio 236.034 which is significant at 0.05.

Regression Analysis for Research Hypothesis 2

H₀: Outsourcing Strategy has no influence profitability.

Table 4.
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.764 ^a	.584	.579	.627

a. Predictors: (Constant), Outsourcing strategy

Table 5.
ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	50.070	1	50.070	127.500	.000 ^a
	Residual	35.736	91	.393		
	Total	85.806	92			

a. Predictors: (Constant), Outsourcing strategy

b. Dependent Variable: Profitability

Table 4 shows that outsourcing yields a coefficient of linear regression r^2 of 0.584 accounting for 58.4% of the variance in adoption of outsourcing by the manufacturing firms in Nigeria. Table 5 shows an F-ratio of 127.5 which is also significant at 0.05.

Regression Analysis for Research Hypothesis 3

H₀: Outsourcing Strategy has no significant effect on Customer Satisfaction.

Table 6.
Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.725 ^a	.525	.520	.656

a. Predictors: (Constant), Outsourcing strategy

Table 7.
ANOVA^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	43.362	1	43.362	100.612	.000 ^a
	Residual	39.219	91	.431		
	Total	82.581	92			

a. Predictors: (Constant), Outsourcing strategy

b. Dependent Variable: Customer Satisfaction

Table 6 indicates that 0.525 (52.5%) of the customers are accounted for by the adoption of outsourcing by the firms. At F- ratio of 100.612 in table 7, this reveals that there is a significant relationship between outsourcing and customer satisfaction which is significant at 0.05.

Discussion of findings

The discussion of findings is based on major issues raised in the hypotheses of the study. All findings were held at a significant level $p < 0.05$

Hypothesis one

The result presented shows that the implementation of outsourcing strategy by the organizations has significantly and positively influenced sales turnover and consequently organizational performances. The research has shown that outsourcing as a strategy adopted by these

organizations has resulted in production cost reduction, competitive selling price and ultimately increased sales turnover. This findings further support resource-based thinking which stipulate that firms-specific resource endowments are determinants of competitive leverage (Rumelt, 1984; Wernerfelt, 1984).

Sales turn over and corporate/technology reputation is affected by stakeholder integration and capability development.

Hypothesis two

The result of the test analysis on this hypothesis shows that outsourcing strategy has significant influence on organizational profitability because production process, constant innovation and concentration on core competence are the activities in which the organizations make use of in order to increase their output and perform better competitively.

Capability development and corporate/technology reputation was linked with the concept of competence trust (Berger, 1993). This was fully supported by the data analysed.

The above findings also aligns with the work of (Jones, 1995; Jones and Wicks, 1999) which postulates that competitive advantage accrue to firm that contract with their stakeholders on the basis of mutual trust and cooperation.

Hypothesis three

This hypothesis states that outsourcing strategy has no significant effect on customer satisfaction.

After testing the null hypothesis, it was discovered that outsourcing strategy has a positive and significant effects customer satisfaction resulting to high organizational performance.

Organizations that integrate the voice of the environment into their decision-making structure tend to accumulate short run economic gains. This result yields further support for instrumental stakeholder theory. Corporate and technology reputation represent an assessment of a firms relative standing by its relevant stakeholders.

Conclusion

Outsourcing strategy is at the center of the process of organizational changes and business structure. In this respect, these processes may be preceded by radical changes which lay the ground work for process re-engineering. The trend towards virtual corporations based on the relationship of cooperation among several firms starts with the identification and exploitation of the concept of core competences, in such a way that new advantages are obtained from specialization and that the customer receives added value superior to the levels previously offered. The contemporary relationship of firms to their business surroundings are conditioned by the changes in technology and the economic environment. Firms face these alterations to their surroundings by making qualitative change in the way that they perform their activities and structure their organization.

Outsourcing has a series of advantages and disadvantages which can be divided for analytical purposes into strategic and operational nature. The main strategic advantages are the creation of competitive advantages, the reduction of risks, an improved long-term cost structure and an increase in organizational sale turnover and profitability. From a strategic standpoint, outsourcing allows the firm to concentrate its efforts on consolidating and expanding its core competences. On the other hand, among the operational advantages, we find an increase in efficiency as a result of activities being carried out by specialized firms and reductions in permanent staff, which then become variable costs related to the level of activity. As for the disadvantages of a strategic nature, the most important are the loss of control of activity done through outsourcing, the transfer of sensitive information, the possibility of exorbitant price increase by the suppliers at a future date, along with fluctuations in quality. The operational problems we have observed are difficulties related to the making of the contract arising from the effects on human resources.

With respect to problems of an internal nature, it is certain that firms have turned to outsourcing as a short-term solution to avoiding the rigidities caused by labor laws. These firms may limit themselves by viewing outsourcing merely as a simple way of freeing themselves of permanent staff. From this perspective, outsourcing could represent a phenomenon of opportunity, while labor legislation is being in accordance with the needs of firms for more flexible organizations and more professional and motivated workers.

In conclusion, outsourcing facilitates the transition to the new flexible organizational models leading to the virtual corporation using a process which is not free of some uncertainties which affect its conceptualization and empirical analysis.

Recommendations

First of all, outsourcing usually reduces a company's control over how certain services are delivered, which in turn may raise the company's liability exposure. Companies that outsource should continue to monitor the contractor's activities and establish constant communication.

Secondly, outsourcing strategy should come from the workers themselves. That is, workers should be made to embrace the strategy before implementation so as to allay the fear of loss of jobs.

Also, successful implementation of an outsourcing strategy has been credited with; cost increase profitability and productivity. Therefore, organizations are system; enjoined to reduce the outsourcing strategy and improve their service delivery.

Company managers agree that successful outsourcing requires a shift in their mindset, which means that they must manage their contractors and workers in order to improve on efficient service delivery. Integrating and managing a diverse, split work force embodying different corporate cultures and perhaps divided loyalties can be a daunting assignment compared to the more traditional approach to work force management.

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URBAN SUSTAINABILITY AND EXPANSION ORGANIZATION IN SOUTH MEDITERRANEAN

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Abstract:

In the Western context, notions of sustainable development often refer to the need to adjust existing economic models in order to maintain better balances between economic growth and social needs, while protecting local ecologies and reducing the negative impact of growth on the global environment.

In the developing world, however, sustainable development takes on a rather different meaning. With the agendas of developing nations focused on addressing basic developmental challenges such as economic growth, water scarcity, food security, and health, other environmental and social aspects are considered secondary at best and, for the most part, a luxury that a developing nation cannot afford.

During the past three decades, Major South Mediterranean city-regions have experienced considerable physical, economic and social transformations. Globalization and economic restructuring has resulted in these city-regions receiving the full impact of urbanization pressures. City-regions such as Dubai, Masqat, Beirut, Amman, and Cairo have advocate expansion organization approaches giving particular interest to urban sustainability in an attempt to ease these pressures. These approaches promote efforts to achieve the triple bottom line sustainability by balancing economic and social development, and environmental protection, and putting (more emphasis on compact and optimum development of urban forms). This paper evaluates the South Mediterranean cities and assesses their experiences in managing their urban forms whilst promoting sustainable patterns of urban development. The findings show that sustainable urban development initiatives employing a top down approach has yielded encouraging results in these case study city-regions. However the need for a more concerted effort towards the overall sustainability agenda still remains vital.

Key Words: Sustainable urban development, expansion organization, compact urbanization, city-regions, South Mediterranean

Introduction

Sustainable development means improving the quality of life of a population within the capacity of Earth's finite resources. The needs of the present generation must be met, particularly those of the poor, without compromising the ability of future generations to meet their own needs (Sheth and Atul 1995).

This is a dynamic process whereby the decision makers involved in any area plan, implement and then re-examine their ideas and policies over time. In South Mediterranean city-regions such as Beirut, Amman, and Cairo, the goal of sustainability has been increasingly highlighted over the past few decades as problems and issues arise from unsustainable practices and developments. Technology plays a vital role in creating the goal of sustainability. Arguably it is the misuse of technology that works against this goal.

Since early 1980s, policy-makers have been looking for ways to move city-regions towards more sustainable forms (Sorensen, Marcotullio & Grant, 2004). The continued expansion of city-regions makes sustainability an issue of significant concern because of scarce world resources (Lindsey, 2003). This continued growth, both in population and consumption, is now putting our ability to a test in managing urban regions more sustainable and effective ways.

This paper explores the implementation of expansion organization efforts in the South Mediterranean Cities. The methodology employed in this paper is a thorough policy evaluation. The paper first reviews the concept of urban sustainability, focusing on the nature and trends of urban development, and its consequences. The second section looks at solutions for addressing problems of

urban growth by introducing concepts and strategies for promoting urban sustainability through compact urbanization. The final section discusses the implications of expansion organization strategies for the South Mediterranean region.

Urbanisation, sustainability and expansion organization

Interest in sustainability and urban development has steadily grown in recent years among. It has become central in planning and managing urban areas in Europe and North America. The various dimensions of urban life – environmental, economic, social and culture – are interwoven and success in urban development. That can only be achieved through an integrated approach.

Measures concerning physical urban renewal must be combined with measures promoting education, economic development, social inclusion and environmental protection. In addition, the development of strong partnerships between local citizens, civil society, the local economy and the various levels of government is a pre-requisite. This has transformed cities in Europe and North America into mega-cities and metropolises. The associated economic development and prosperity experienced by these European and North American cities have prompted Asian cities to emulate these achievements.

There is a strong belief that urbanization is crucial to the process of development, and an inevitable process of creating a modern state (McGhee, 2009). Indeed, the rapid urbanization of Asian cities in general has brought about rising income and living standards to the cities' population. The world development indicators data compiled by the World Bank, for example, shows that developing countries in South Mediterranean have been experiencing a significant growth of their GDP over the last 10 years and their share of the global economy has risen from 13 percent in 1995 to 19 percent in 2005 (World Bank, 2009). However, Asian cities, cities in South Mediterranean in particular, are struggling to keep up with the rapid urbanization pressures caused by rapid population increase and expanding city sizes. These pressures have created what is generally known as urban sprawl, characterized by low density suburban development patterns. Urban sprawl takes three main forms: suburban expansion into the countryside, commercial expansion along arterial roads, and residential sprawl outside existing settlements (Daniels, 1999).

The consequences of sprawl have been viewed differently by planning scholars. Benefits of sprawl include private and social benefits to new residents and the community, for example in terms of housing costs (Kahn, 2001), potential for population growth accommodation (Brueckner, 2000), and symbol of economic prosperity (Nelson & Duncan, 1995). However, this phenomenon has also been associated with an array of undesirable physical and socioeconomic effects (Nelson & Duncan, 1995; Boyle & Mohamed, 2007). These include: scattered development, excessive commuting and transportation costs, infrastructure and services provision costs, socio-economic segregation through inequitable land and housing markets, increasing consumption of natural open space, and other 'quality of life' problems (Nelson & Duncan, 1995; Carruthers, 2002).

Urban management strategy options

City governments introduced a variety of approaches to control sprawl and limit further damage to the limited resources that they have due to the problems associated with rapid urbanization. The term urban management or urban expansion organization has been used interchangeably to reflect these efforts, and a variety of expansion organization techniques have also been introduced to apply expansion organization concepts into practice. The reason for adopting expansion organization approaches in cities was coming from the need to achieve a balanced and sustained urban development. Urban sustainability has long and flourishing roots in Europe and North America, where urban sprawl was first identified. Calls for adoption of sustainable urban development and management were at its height at the Rio Summit in 1992 following the World Commission on Environment and Development report on sustainable development.

Many believe that compact urban development contributes to urban sustainability, which is one of the key aims of expansion organization initiatives (De Roo & Miller, 2000; Assumer, 2006). A number of strategies have been developed and employed to achieve compact urban development (Nelson & Duncan, 1995). Containment based management supported by sustainable urban transport has been one of the most successful compact urbanization strategies (Nelson et al. 2004; Yigitcanlar and Bunker 2009). This strategy attempts to promote the following: compact and contagious urban development patterns with easy access to public services; travel-self containment with reliable public transport options and integrated land use and transport planning, and; preservation of rural and

agricultural land and natural resources (Nelson & Duncan, 1995; Duvarci & Yigitcanlar, 2007; Yigitcanlar and Bunker 2009).

Compact urbanization strategies determine the direction of public infrastructure investment, execute development regulation and shape the nature and intensity of development. Containment scales vary between sub-metropolitan (development shaped to take a specific form), unbounded (development within urban service boundary), bounded (development within a designated growth boundary), and natural containment (development restricted by geographical constraints) (Nelson et al., 2004). Around the world many cities implemented a variety of containment techniques that range from urban growth boundary to urban service area, and from land taxation to open space preservation. Successful implementation of containment techniques and experiences from North America and Europe provide invaluable insights to many city-regions seeking sustainable urban development. The implementation of strict development regulations associated with containment techniques enables local authorities to encourage development in existing urban cores and dilapidated inner areas through infill and redevelopment projects, including not only prestigious but also affordable residential development. The promotion of higher residential densities in these infill areas helps to offset the high development costs resulting from urban containment and to minimize public infrastructure provision. Zoning is commonly used for such a purpose. It allows for higher density development on the land used to accommodate low-rise dwelling units, hence making the properties more affordable to a majority of urban dwellers.

Sustainability indicators

The increased environmental agenda has brought about the need to employ indicators as a key mechanism for assessing environmental impacts (Hemphill, 2004) and as policy instruments in the transition toward urban sustainability (Hezri, 2005). There is a common view that sustainability indicators can be meaningful provided they are applied at the appropriate level (Brownhill and Rao, 2002, cited in Hemphill, 2004). Such indicators can be crucial in developing an awareness of urban problems and advocating the need for the achievement of sustainable development (Stanners and Bourdeau, 1995). They can contribute to the assessment of the performance of individual agencies/interventions, and of the overall effectiveness of partnerships to improve economic, social and environmental wellbeing of urban settings.

However, most indicator-based approaches only highlight issues; they do not provide answers as to why differences exist. Key indicators must be supplemented by qualitative and quantitative information on impact and performance from the perspectives of users and beneficiaries. In recent years, the best starting-point for assessing sustainable practices has been the Bellagio principles developed by the International Institute of Sustainable Development (IISD) (Hemphill, 2004). These principles serve as guidelines for the assessment process, including the choice and design of indicators, their interpretation, and the communication of results, to provide a link between theory and practice.

Sustainable urban development in south mediterranean

During the past three decades, cities in South Mediterranean region have undergone massive transformations (Marcotullio, 2004). Major cities experienced vibrant population growth, and major physical and functional urban transformations.

These city-regions received the full impact of urbanization pressures due to the rapid pace of globalization and economic restructuring. In an attempt to ease these pressures, major cities have advocated expansion organization approaches giving particular interest to balanced economic and environmental sustainability and put more emphasis on compact and optimum development of urban forms (Degree, 2005).

In conclusion, within the context of resource constraints, sustainable urban development has been a key factor in the adoption of urban expansion organization initiatives promoting viable use of scarce resources for urban expansion whilst at the same time minimizing uncontrolled urban sprawl. Within this context, the use of a whole range of policies designed to control, guide, or mitigate the effects of urban growth is seen as a practical way to promote compact development (i.e. Nelson & Duncan, 1995). The rapid population growth and urbanization in South Mediterranean City -regions has indeed placed great pressures on their environments. Whilst a few cities in the region, have adopted some form of urban management policies towards minimizing or alleviating these pressures, many other cities within the region are still without suitable urban expansion organization strategies

(i.e. Bagdad and Damascus). In these cities, higher land consumption, expansive and discontinuous urban development will continue into the future. Local authorities and planners should, therefore, look into the possibilities of implementing sustainable urban growth/development management strategies for their cities. Both case studies investigated in this research display top-down approaches to ensure that planning at the district and local levels is properly guided to achieve state and regional standards and goals. In some cases (Cairo and Amman), urban development is facilitated and governed by statutory planning legislation and flexible planning processes and approaches. This ensures that all development will have some degree of standardization and will occur in harmony with existing development. It seems that from these cases, a top-down approach is a key factor to trigger sustainable urban management practices. However, these top-down approaches need to be balanced with bottom-up, collaborative strategies in order to provide a more transparent and democratic platform for citizen participation in the urban planning and development process.

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HOUSEHOLD DEMAND FOR ISLAMIC FINANCE IN SELECTED COUNTRIES

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Abstract

The term Islamic Finance (IF) can generally be defined as the provision of financial services and products on the principles of Islamic shariah (law). Some basic principles of Islamic Finance are prohibition of *riba* (interest), *gharar* (uncertainty), and gambling. Another defining characteristic of Islamic Finance is that it is supposed to link financial transactions with activities in real economy and arrange for sharing of entrepreneurial risk. It is predicted by the International Organization of Securities Commission that by 2015, investments undertaken according to these principles will account for half of the savings of the world's estimated 1.2-1.6 billion Muslims. Yet, we have very little insight into economic preferences of Muslim populations living in Western societies when it comes to shariah compliant investment opportunities. A 2010 report on Islamic Housing Finance in Canada commissioned by the Canada Mortgage and Housing Company notes that without such information it is impossible to understand how market demand would respond to an ever growing array of Islamic Finance products and services. This paper documents some stylized facts about housing choices of immigrants in Italy as well as providing some comparison of the UK and the Canadian context. This is intended as a first step in uncovering household preferences for various investment alternatives among Muslim population in selected Western economies.

Key Words: Housing, Investment, Immigrants, Islamic Finance

Introduction

According to a report published in 2009 by Pew Forum on Religion & Public Life on the size and distribution of world's Muslim population, nearly 40 million Muslims live in Europe. In particular, Germany and France have the largest population of Muslim minorities in the euro area at over 4 million and 3.5 million respectively. In light of these figures, it is an interesting question how household portfolios in these large European economies might have responded to the strong global growth of Islamic Finance since its inception in modern form four decades ago. Given that almost all multinational banks offer some sort of Islamic financial assets alongside conventional financial assets, the effect on household portfolio decisions might also extend to those investors looking for an "ethical" finance alternative regardless of their religious background.

The term Islamic Finance (IF) can generally be defined as the provision of financial services and products on the principles of Islamic shariah (law). Some basic principles of Islamic Finance are prohibition of *riba* (interest), *gharar* (uncertainty), and gambling. Another defining characteristic of Islamic Finance is that it is supposed to link financial transactions with activities in real economy and arrange for sharing of entrepreneurial risk. It is predicted by the International Organization of Securities Commission that by 2015, investments undertaken according to these principles will account for half of the savings of the world's estimated 1.2-1.6 billion Muslims. Yet, we have very little insight into economic preferences of Muslim populations living in Western societies when it comes to shariah compliant investment opportunities. A 2010 report on Islamic Housing Finance in Canada commissioned by the Canada Mortgage and Housing Company notes that without such information it is impossible to understand how market demand would respond to an ever growing array of Islamic Finance products and services. Earlier work by Maurer (2006) on Islamic mortgages in United States also underlies this lack of systematic studies about Muslim attitudes towards Islamic Finance in particular countries or across different countries.

Understanding consumer preferences for this particular sector of alternative finance can also help shed light on investor preferences for Socially Responsible Investment (SRI). Socially

Responsible Investment is a fast-growing financial sector that manages more than 3 trillion US dollars in US alone according to the 2010 Trends Report. Its relevance to Islamic Finance from an investment strategy perspective lies in the overlap of their screening procedures that prohibit financing businesses such as weapons, tobacco, and pornography. This common ground appears to be a major marketing and public relations point for Islamic Finance especially in European countries such as France where the term Ethical Finance is favored over Islamic Finance in part to fend off negative public opinion over the religious connotation.

Main Text

The 2012 Islamic Finance Guide reports that real estate sector dominates the most recent market developments in Islamic Finance in countries such as UK and Canada. Home ownership remains an important financial goal among the Muslim population in Canada, which is projected to triple in the next 20 years to account for 6.6% of Canadian population by 2030 according to a recent report by Pew Forum on Religion and Public Life. In UK, one of the contributing factors to the development of the housing sector of the Islamic Finance market was the 2004 abolishment of double stamp duties resulting in more competitive shariah compliant mortgages. Another important development in 2004 was the launch of Islamic Bank of Britain as the first standalone Islamic Bank in the Western world with the approval of the Financial Services Authority. Currently, there are about 20 banks providing shariah compliant products and services through Islamic windows including some big banks such as HSBS and Lloyds TSB. Consequently, UK established itself as the leading European country in Islamic Finance activities. The UK experience can provide a useful road map for considering how the expansion of Islamic Housing Finance fits within the current Canadian legal, regulatory and tax framework.

In contrast to UK, currently there are no Islamic Banks or windows operating in Italy. Nevertheless Italy remains an interesting case due to government involvement in producing detailed market studies to promote the country as a viable market for Islamic Finance. The country report published in the 2012 Islamic Finance Guide mentions the availability of extremely detailed surveys and market analyses categorized by the countries of origin and the banking services used by the Muslim community in Italy. These data could be utilized to study financial behavior of the Muslim community to fill the existing gap in our knowledge of consumer preferences toward alternative investment opportunities. Such a study could provide interesting insight since the Italian Muslim population is characterized by a variety of countries of origin and not dominated by a single nationality more like the Canadian Muslim population.

The 2011 Italian Report on Migrations provides interesting statistics comparing housing situation of immigrants and Italians. The report is based on Income and Living Conditions survey study conducted by Istat (Italian National Institute for Statistics) in 2008. In the survey, the immigrant status is defined by country of birth where those born outside of Italy are classified as either EU immigrants or extra-EU immigrants. According to statistics provided from the survey, renting or subletting is most common among extra-EU immigrants with 58.8% compared with only 16.1% of renters among Italians. In contrast, a high percentage of Italians are homeowners. Specifically, 71.4% of Italians live in a house they own whereas only 28.4 of extra-EU immigrants are homeowners. In both cases, the figures for EU immigrants fall in between the two although their housing situation resembles that of other immigrants more closely. The survey also provides information on mortgages and other loans homeowners take out for purchase or renovation as well as the interest rates carried on these loans.

The figures provide a very interesting comparison on relevant economic data and indicate further investigation into possible sources of the difference in housing situation is worth undertaking. The literature on determinants of homeownership provides evidence that certain demographic factors such as marital status and financial variables such as income uncertainty have significant effect on homeownership rates. For example, Fisher and Gervais (2011) show that most of the decline in number of young homeowners in US between 1980 and 2000 can be explained by increasing income risk and an increasing trend for marriage age observed during the same period. In the Italian population surveyed by the Italian National Institute for Statistics, employment stability appears to be different between Italians at 10% and immigrants at 15%. Whether the observed variation in employment stability could have a similar causal effect on home ownership as income uncertainty is

an interesting question that deserves further investigation. Marriage status should also be investigated as a potential determinant of difference in homeownership across immigrants and Italians.

It should be stated that although the survey sheds light on some important aspects of the housing status of immigrants in Italy vis-à-vis Italians, it stops short of identifying the immigrant's country of birth. It also provides no information on religious affiliation. Therefore, it is not possible to quantify the casual effects of any ethical considerations based on religious affiliation on home ownership decision. The next step in uncovering household preferences for various investment alternatives among Muslim population in Western societies is control for these factors using datasets that collect demographic and financial variables for groups of households with different religious affiliations.

Conclusion

In a nascent industry like Islamic Finance that existed in its modern form only for the last 30 years or so, availability of public data accessible through well established and clearly announced procedures remains a challenge for empirical research. Increased interest in understanding household preferences for Islamic Finance by both the industry and the academic circles is encouraging for collection, distribution, and analysis of relevant data.

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INVESTIGATIONS ON THE EURO AREA PUBLIC DEBT CRISIS: THE CASE OF PIIGS

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Abstract:

The crisis that emerged following the bankruptcy of Lehman Brothers which is the fourth largest investment bank in the United States quickly spread to the entire world and has globally become a financial and real sector crisis. Today, the global financial crisis has influenced many countries in the world, and caused various economic, political and social problems in the European Union countries especially in Greece, Italy, Ireland, Portugal and Spain (PIIGS).

The global financial crisis became the European Union's economic crisis at first, and later turned into to be the debt crisis of the Euro area. The decline observed in recent years in the economic performance of the countries of the Euro Area has become more apparent along with the economic crisis, and this situation increased the concern about the future of the Economic and Monetary Union. In this context, in this study within the framework of global capitalism, the economic, social and political problems that the global financial crisis caused in many countries are examined, observations were made on the Euro area public debt crisis and analyses were carried out on the PIIGS economies.

Key Words: Euro Area, Public Debt Crisis, PIIGS

Introduction

The change that the globalization around the world caused in the economic, social and political areas began to emerge along with the global financial crisis in 2008. The financial crisis that erupted in the United States took hold of the whole world in a short time and turned into a crisis on the global scale.

The negative developments in the financial sector quickly influenced the real sector. The economy of many countries especially the United States and the European Union countries entered the period of recession. In this context, the effects of the crisis of 2008 on the economies of countries are mainly seen on the macro-economic indicators such as decline in the development rate, increasing deterioration in the budget balance, increase in the debt rates, growth in the current account deficit, high decreases in the value of import and export, decrease in the rates of total investments and increase in the rates of unemployment.

The economic crisis had a negative impact on the Euro Area countries in which the economic and monetary union in the European Union is provided. The public deficits and debt stocks extremely increased in the EU member countries and the sustainability of public finance in many countries is imperilled.

Among these countries, Greece, Italy, Portugal, Ireland, Spain (PIIGS) influenced the Euro Area and therefore the European Union with their crisis of banking and external debt. These countries began to feel more severely the effects of the global economic crisis. In this context, the measures taken against the crisis in these countries have failed to achieve exactly the desired effect.

All these negative developments in the social, political and economic areas have revealed the deficiencies of the system of Euro and brought forward the issue that current policies and mechanisms need to be strengthened in order to maintain the stability and viability of the Euro Area.

Global capitalism and economic crisis

The process of globalization that started to gain importance especially in the 1980s throughout the world accelerated along with the developments in the field of information and technology observed in many countries and along with many developments in the world till the 1990s. In this context, along with the rapid development and transformation emerging in the process of globalization, the capital stock has exceeded the boundaries of the nation-state (Bauman, 1998: 70).

As the globalization accelerated, the national funds of the countries have turned into a structure having no borders and many companies have become a multinational structure. As a result of these developments, the nation-states are now estranged from the position of being the only determinant of the economic and social policies and the national economic policies have relatively lost their function (Cable, 1996:20-21).

The internationalization of the fund in many countries around the world has developed depending on the financial liberalization at the same time. In this context, if we define financial liberalization; it is the applications in which the countries reduce or remove the supervisions and limitations especially on the financial system in order to attract their international financial activities to their own countries. In other words, it can be expressed as the process of opening up of the national economies to the international capital flows (Ongun, 1993:38).

The liberalization of capital movement between countries in the 1980s and the acceleration of the capital flows after the 1990s, and as well as labour gained mobility are among the most important results the globalization caused (Çevik, 2004:154). In the process of globalization, protectionism disappears, liberality is provided to the foreign capital flow, and the interaction of countries is made easier through the foreign trade channels of countries. In this context, the mobility of the production factors between countries around the world has increased to a great extent.

In addition, the globalization trends have caused significant changes in the economic policies of states. Especially the developing countries have entered the process of liberalization spreading rapidly since the 1970s and their economic structures have changed. In this context, with the rapid process of globalization, financial liberalization and international markets integrated to each other began to be a current issue. In this context, as the impact of globalization increases, the solutions based on national supply and demand left its place to the solutions based on global supply and demand (Meriç & Ay, 2004:303).

As the globalization accelerated, the financial liberalization trends emerged especially in the developing countries has caused deteriorations in the macroeconomic structures of the countries on the one hand, and the financial structures of these countries to become more fragile on the other hand. The fluctuations in the flow of especially the short-term capital flows disrupt the financial stability and cause economic crisis (Aktel, 2003:89).

The global economic crisis have a negative impact on not only the macroeconomic stability of the developing countries but also on the economic relation with the outside world such as the foreign investments, exports, foreign aids and foreign debt which contribute to the development of these countries.

In this context, the policy of low interest the United States implemented has caused disruptions firstly in the real estate markets. However, as a result of that this situation is reflected to the real and the foreign markets, a global crisis occurred (Şimşek & Altay, 2008:11). In this context, the reflection of the crisis which began in the financial sector in the U.S. to the real sector and other economies actually has shown that the real sector in developed economies is also vulnerable to crises (Önder, 2009:17). In this context, since the global financial crisis emerged in an environment which the financial markets have globalized, it affected the developing countries more compared to the other earlier crisis.

The global financial crisis and its effects to the european union

With the liberalization of capital movements and the globalization of the capitalist system throughout the world, the crisis emerging especially in developed economies has begun to spread to the global area much more easier and faster. In this context, the economic crisis emerged as a result of the problems occurred in the real estate sector in the United States in 2007 began to impact the economies of other countries in a short time (Krugman, 2009:185). The global financial crisis arising from the financial system and that affects the economies of other countries soon have caused many negative impacts on the macroeconomic indicators of many countries (Arıkan, 2008:17).

The crisis that affected many countries developed worldwide especially in 2009 and caused highly significant constrictions in the economies of developing countries. In this process in which the environment of confidence has collapsed completely, the liquidity crisis began to be experienced along with the credit crisis (Furceri & Ugane, 2009:7). In this context, the developments occurred in this process and afterwards are generally accepted as the biggest crisis that occurred after "the Great Depression in 1929".

In general sense, the subprime mortgage sector, expanding volume of credit, inadequate financial regulation and developments in supervision and global macroeconomic imbalances have caused the global financial crisis. However, the negative effects of the inactive monetary and fiscal policies that are implemented for very long periods in especially developed countries are also among the reasons of this crisis (Mohan, 2009:104).

The negative effects of global crisis in the fields such as growth, production, investment and employment required public interventions. The developed and developing countries also took some measures especially in monetary policies, fiscal policies and financial policies in order to reduce the effects of the global crisis that effected many countries around the world.

As the effects of the global crisis are felt, the applications of fiscal policy have been implemented in order to help the applications of monetary policies. As the interest rate cut and the applications of monetary policies implemented in the form of liquidity support remained insufficient in the first periods of the crisis, the instruments of fiscal policy came to the agenda (Batrel, 2008:2). However, the monetary policy, fiscal policy and policy measures for the financial sector aimed at reducing the impact of the crisis on the reel sector and at re-allocation of the confidence to the financial sector, unfortunately, have not been fully effective.

Reflection of the global crisis to the european union

The global economic crisis that began in 2008 caused many economies in the world to enter in a highly deep period of recession. The member countries were affected altogether due to the common external trade policy implemented by the EU. Many EU countries have introduced comprehensive economic stimulus packages along with the monetary expansion in order to reduce the effects of the crisis on economy. However, since the monetary system of the EU eliminated the possibility of implementing the loose monetary policy for many countries, implementation of expansionary monetary policies took some time (Pauly, 2008:78).

Most of the EU governments supported the private sector by reducing the taxes and social security premiums, through early payment of the rebates of VAT, incentives and export promotions as well as the measures that support the affordability of the household by reducing VAT, social security contributions and direct taxes. Despite these support packages, the economies of EU could not avoid from narrowing significantly in 2008 and 2009.

In this context, increased debt stock and interest rates due to the decline in the tax revenue caused by the narrowing experienced in the economies of EU countries and crisis also caused public expenditures and deficits to increase in the EU. Ultimately, the macroeconomic problems experienced in the EU countries after the crisis turned into a debt crisis by causing high public debts and budget deficits as well as the causing problems in growth rates, employments, investment and savings, production and high inflationary pressures (Reinhart & Rogoff, 2008:4). While the economic problems caused by the global financial crisis have not yet been fully solved, this time, the debt crisis emerged in the EU countries made a mark on the world economy.

Evaluations on the euro area debt crisis

Budget deficits and increasing debt burdens began to appear with the global crisis in 2008 in many countries in the EU. In addition, it has been observed that in many countries the governments could not adequately control their current economic policies and in this context could not generate strong control mechanisms (Welfens, 2010:5).

The negative effects of the crisis were seriously felt in the EU countries and the Euro Area experienced the biggest narrowing in its history by shrinking 4.1%. The global crisis caused public deficits and debt stocks in EU countries to increase seriously and caused the sustainability of public finance in many countries to be in danger.

The reduction in the total tax revenue of the member countries caused total debt burdens to increase by causing the borrowing need to increase and therefore causing an increase in the debt interest payments (Tanzi, 2004:54). Therefore, the increases in the public deficits caused not only

financial problems but also increase in interest and inflation on the debts of the state. In this context, the effects of the global economic crisis on the economies of PIIGS will be examined with the help of the following tables.

Table 1. Annual growth rates of piigs (%)

	2005	2006	2007	2008	2009	2010
Ireland	6,7	8,7	8	-2,2	-6,2	-0,8
Greece	4,7	9	2,2	1,3	-11,3	-6,3
Spain	1,3	2,3	2,7	-5,4	-5,4	-2,7
Italy	-0,4	1	-0,2	-2,6	-1,3	0,4
Portugal	7,8	1,2	0,3	0	-1,7	-0,3

Reference: Eurostat; “Economy and finance statistics”, <http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes>

It is possible to observe the effect of the global crisis on the growth rates of the economies of PIIGS in the table above. If we examine in this context, the growth rates in the economies of Ireland, Greece, Spain, Italy and Portugal (PIIGS) showed reductions since 2007 and especially in 2009, the growth rates in terms of all the countries mentioned above reduced sharply. This situation began to show a tendency to improve since 2010.

Table 2. Tax revenues of piigs (GDP %)

	2005	2006	2007	2008	2009
Ireland	32,2	33,6	32,9	31,3	29,6
Greece	34,1	33,4	34,2	34	32,9
Spain	36,4	37,2	37,9	34	31,3
Italy	40,7	42,3	43,3	43,2	43,4
Portugal	35	35,7	36	35,7	33,9

Reference: Eurostat; “Economy and finance statistics”, <http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes>

In the period of global crisis, contractions in production, employments and total demand were experienced in the economies of many countries around the world. Therefore, the tax revenues that have a significant share in the total income in the economy of a country decreased. The effects of the global crisis on the tax revenues in the economies of PIIGS are given in the table above. In this context, during the period of the crisis, the share of the total tax revenues in the economies of PIIGS within the GDP decreased especially in 2008.

Table 3. Social protection expenditures of piigs (GDP %)

	2005	2006	2007	2008	2009	2010	2012
Ireland	17,95	18,25	18,76	22,04	27,88	22,8	19,8
Greece	24,85	24,72	24,80	26,27	27,97	23,2	23,1
Spain	20,58	20,53	20,68	22,12	25,04	26,7	25,3
Italy	26,38	26,64	26,73	27,81	29,82	27,5	26,4
Portugal	24,59	24,59	23,89	24,35	26,94	26,1	25,4

Reference: Willem Adema, Pauline Fron, Maxime Ladaique; “Is the European Welfare State Really More Expensive?”, 2011. <http://epp.eurostat.ec.europa.eu>

As can be seen in the table above, there have been increases in the shares of social expenditures in the economies of PIIGS within GDP especially in 2008. In this context, it was intended to establish an effect that can increase the total demand in the economy by increasing social expenditures in these countries.

Table 4. Basic public financial indicators of piigs (GDP %)

	PUBLIC EXPENDITURES				PUBLIC REVENUES			
	2007	2008	2009	2010	2007	2008	2009	2010
Ireland	36.6	42.8	48.9	66.8	36.7	35.5	34.7	35.5
Spain	39.2	41.5	46.3	45.6	41.1	37.0	35.1	36.3
Italy	47.6	48.6	51.6	50.3	46.0	45.9	46.3	45.8
Portugal	44.4	44.8	49.9	51.3	41.1	41.1	39.7	41.6
Greece	47.6	50.6	53.8	50.2	40.8	40.7	38.0	39.5

Reference: Eurostat; "Economy and finance statistics", <http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes>

The social protection expenditures that the countries made in order to stimulate total demand in the economy in the period of global crisis and as well as the costs of bank rescue with other incentives caused high increases in the public expenditures. The fact that financing of high public expenditures occurring in this context is met through borrowing has caused negative effects on the budget balance and the debt stock. Thus, during the period of the crisis, the balance of public expenditure and revenue began to deteriorate increasingly.

The fact that some banks in the EU countries nationalized their debts during the period of the crisis has caused public debt to increase to very serious levels and concerns on repayment of the debt emerged. Consequently, this situation caused a debt crisis in the countries such as Greece, Ireland, Portugal, Spain and Italy whose debts are high.

Table 5. Bank debts of piigs (billion dollars)

DEBTOR COUNTRIES	COUNTRIES THAT LEND	AMOUNT OF THE DEBT	TOTAL DEBTS
GREECE	GERMANY	45	135
	FRANCE	75	
	ENGLAND	15	
PORTUGAL	GERMANY	47	116
	FRANCE	45	
	ENGLAND	24	
ITALY	GERMANY	190	778
	FRANCE	511	
	ENGLAND	77	
SPAIN	GERMANY	238	572
	FRANCE	220	
	ENGLAND	114	
IRELAND	GERMANY	184	432
	FRANCE	60	
	ENGLAND	188	

Reference: Economic and Strategic Consulting Services; "Debts of Countries to the Banks in Europe", Information Management, 2011. <http://esdh.com.tr/pdf/avrupada-ulkelerin-bankalara-borclari.pdf>

The PIIGS countries chose to the way of borrowing from other countries in order to save many banks from bankruptcy in the economies of PIIGS. In this context, the countries that chose the way of borrowing are generally Germany, France and England. In this context, the amounts of debt and total debts that Greece, Ireland, Portugal, Spain and Italy borrowed from these countries are given in the table above. If we examine in this respect, the country that has the highest debt is Italy with a debt of 778 billion dollars.

The administration of the EU which was late when the global crisis emerged in the United States and then influenced the whole world is headed to the Euro zone caused the member countries to face the problems of high debt burden (European Economy, 2009:46). In this regard, the debt burden of the governments of the EU which was 7.1 trillion € in 2006 has increased to 8.6 trillion € with the activation of rescue packages at the end of 2009 (USAK, 2011:2). In this context, the debt crisis increasingly deepening in 2010 caused big problems in the Euro Area and ultimately the Euro Area debt crisis came to the agenda.

Table 6. Basic macroeconomic indicators of piigs

	GSYİH (% Change)					BUDGET BALANCE (GDP %)				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Ireland	5.322	5.626	-3.548	-7.580	-1.041	2.933	51	-7.339	-	-
Spain	4.017	3.572	0.864	-3.722	-0.147	2.016	1.903	-4.151	-	-
Italy	2.036	1.482	-1.323	-5.217	1.296	-3.337	-1.499	-2.685	-5.305	-4.598
Portugal	1.440	2.386	0.018	-2.474	1.398	-4.050	-2.768	-2.929	-9.342	-7.303
Greece	5.167	4.279	1.023	-2.045	-4.535	-6.122	-6.669	-9.535	-	-
									15.368	-9.570
	PLAIN BOROWING (GDP %)					CURRENT ACCOUNT BALANCE (GDP %)				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Ireland	12.155	12.175	23.037	38.039	69.385	-3.555	-5.346	-5.650	-3.040	-0.723
Spain	30.528	26.523	30.423	41.829	48.752	-8.972	-9.992	-9.739	-5.532	-4.487
Italy	89.793	87.322	89.164	97.099	99.561	-2.581	-2.439	-2.934	-2.084	-3.503
Portugal	58.771	58.111	61.093	71.883	79.096	-	-	-	-	-
Greece	106.10	105.06	110.33	126.81	142.02	10.724	10.119	12.614	10.925	-9.871
	7	7	2	3	4	-	-	-	-	-
						11.244	14.358	14.688	10.986	10.448
	IMPORT (% Change)					EXPORT (% Change)				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Ireland	6.432	7.772	-2.946	-9.745	6.560	4.836	8.161	-0.797	-4.134	9.447
Spain	10.219	7.962	-5.261	-17.806	5.441	6.690	6.716	-1.101	-	10.279
Italy	7.463	5.187	-6.517	-19.108	13.890	7.809	6.244	-6.324	-	12.103
Portugal	2.350	7.422	5.143	-12.645	-5.777	10.058	11.761	2.991	-	-0.699
Greece	9.654	9.842	3.980	-18.613	-10.784	5.322	5.752	4.018	-	2.156
									20.071	
	TOTAL INVESTMENT (GDP %)					UNEMPLOYMENT RATE (Total Labor %)				
	2006	2007	2008	2009	2010	2006	2007	2008	2009	2010
Ireland	28.020	27.294	22.266	14.061	10.809	4.425	4.575	6.325	11.825	13.625
Spain	30.984	30.983	29.088	24.420	22.990	8.513	8.263	11.327	18.010	20.065
Italy	21.615	21.870	21.238	18.911	20.192	6.783	6.158	6.750	7.817	8.492
Portugal	23.134	22.896	23.064	19.724	18.620	7.783	8.100	7.733	9.617	10.983
Greece	20.387	21.868	20.516	16.103	14.556	8.892	8.292	7.683	9.375	12.458

Reference: International Monetary Fund; "World Economic Outlook Database", April 2011. <http://www.imf.org/external/pubs/ft/weo/2011/01/weodata/index.aspx>

As can be seen in the table above, deteriorations occurred in the basic macroeconomic indicators in the economies of PIIGS during the period of the global crisis. GDP showed a negative trend in 2008 and 2009 compared to other years. In addition, the import and export values declined in these periods, the unemployment rates increased and total investments decreased significantly.

Within the framework of the criteria related to public finance, the condition that the rate of the budget deficits of the member countries does not exceed 3% of the rate of gross domestic product (GDP) and that the rate of the public debt stocks does not exceed 60% of the rate of GDP were stipulated with the Treaty of Maastricht in the European Union (Samsun, 2004:15). However, when we look at the table above, we see a value much higher than these criteria in terms of some countries. For many countries, the public debt stock and the budget deficits occurred above the criteria of Maastricht.

The high budget deficits increased the need borrowing requirement in the Euro area countries and the high debt stocks caused social, political and economic problems. With the global crisis, the manufacturing industry began to decline in many countries especially in Greece, Ireland, Portugal,

Italy and Spain and the balance of external payments of these countries began to deteriorate (Bagus, 2010:42). In addition, these countries had difficulty in borrowing from the international markets. In this context, Greece, Ireland and Portugal were assisted by the IMF and the EU (Dadush, 2010:1).

In this context, it is expected that the process of getting out of the crisis will be a long process. This situation will result in instability and volatility in the financial markets (Oliver, 2011:2). In this regard, the Euro area debt crisis has clearly demonstrated the necessity of taking effective measures and making policies in ensuring and strengthening financial discipline in the Union and the coordination between the national economic policies of the member countries. Therefore, in the process of coping with the crisis, the issues that the member countries the member states need to give priority in their economy and fiscal policies can be listed as follows (European Commission, 2011:3);

- That the member countries implement pro-growth fiscal policies
- Improving the capacity of granting loan in economy
- That growth and competitiveness are supported
- Combating the social consequences of unemployment and the crisis
- Modernization of the public administration

In addition, the countries that entered debt crisis in the European Union in this context, especially Greece, Ireland, Portugal, Italy and Spain should firmly implement the policies of fiscal discipline (Oliver, 2011:2). They must be prudent in the macroeconomic policies and take necessary measures to ensure and maintain economic stability. These countries should make configuration of debts in order to reduce the public debt burden (Sibert, 2011:2).

Measures lowering the labour cost should be taken in order to eliminate the reduction in the competitiveness. In the pre-crisis period, the wage increases remained well above the productivity increases in many member countries (Felipe & Kumar, 2011:26). In this context, measures should be taken against this and the manufacturing industry should be re-boosted (Bagus, 2010:123).

In addition, in this direction, a number of measures were taken against the debt crisis in the European Union. These measures; it was decided that the budgets of the member countries should be approved by the EU Commission in order to ensure fiscal discipline in the Euro zone and to carry out the common fiscal policies (Europa Press Releases, 2010:1). However, it was aimed that a Competitiveness Pact should be created that provides many economic and social reforms to be realized by the member states.

Conclusion

As a result of the global crisis, various measures have been taken in many countries especially in the United States and the European Union, but some effect of the crisis could not be resisted. One of the greatest reflections of the global financial crisis on the economy has been the increases seen in public deficits.

There are many reasons of why public deficits have reached high levels during the period of the crisis. Among these, the financial support programs implemented by the governments during the period of the crisis and the tax reductions played an important role. Against the crisis, many countries chose the way of borrowing to finance their public expenditures due to the reductions in tax revenues and as a result of this there have been important increases in the debt stocks of the countries.

The debt crisis in Europe which is one of the most important centers of gravity in the world economy continues to threaten the global economy and to be the biggest risk factor. During this period, note reductions were made in succession by the credit rating agencies toward the economies and banks in Euro Zone the debt crisis. In this regard, it is of great importance to find a common solution in terms of EU countries. In this context, it is of great importance to make regulations toward a common fiscal policy as well as a common monetary policy.

The harmonization the economy policies of the member countries are of great importance in order to increase the economic integration between the Euro Area countries. When we look from the aspect of Euro Area, a more alignment and integration should be provided in the field such as more political integration, tax, finance and budget policy in order to ensure the sustainability of the common currency of the union. In this context, getting out of the crisis basically caused by extensive borrowing can be possible with the restructuring of the debts and providing the fiscal union.

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MERGERS AND ACQUISITIONS: A REVIEW OF EPISODE, FAILURE AND SUCCESS NEW MANTRA

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Abstract:

Collaborations, strategic alliances, powerful partnerships will strengthen the economy. Encouragements from Governments through legislations and tax concessions will further strengthen mergers and acquisitions. This study focuses on factors for the failure of mergers and acquisitions globally and more particularly in India and to review the success mantra for effective implementation of mergers and acquisitions. This research paper is conceptual in nature. The studies undertaken guide the management and persons involved not to fail to understand the reasons for pre and post merger failures. Understanding culture, training of managers to develop change agents, communication to stake holders, building targets, developing a new culture, leader to lead, careful planning and implementation at each stage of mergers make merger successful.

Key Words: Mergers and Acquisitions, Implementation, Failure & Success, Mantra

Introduction

The mergers and acquisition play a significant role in the industrial sector of any economy. "Some people run the race on their own without purposes. Running by individual takes time. Collaborations and strategic alliances make the race winning" Peter Drucker. It is neither capital nor knowledge, but the ability to form powerful partnership. All over the world record number of mergers and acquisitions deals takes place throughout the year. Mergers and acquisitions result in privatization of the public undertakings in Europe, North America, China, Brazil which indicates that the trend towards rapid growth of private Equity Funds. Winning depends on ability to understand the entities to merger implement and succeed. Government of India brought section 2 (IB) and 72A under the Income-Tax Act in order to encourage mergers, acquisitions and demerger of companies. Capital gain on transfer of properties, exchange of shares and debentures by Transferor to Transferee Company are exempted provided certain conditions are fulfilled mainly to attract mergers and acquisitions of companies to strengthen the economy. Between 2007 and 2009 Indian companies established 143 dealings related to merger in the US ranges between \$0.8 million and \$1,005 million (Joint report on 'Direct investments in the US by Indian enterprises', Ernst & Young and FCCI). The Indian companies have moved from horizontal, vertical, hostile merger to strategic mergers not only in India but also globally. After liberalization of Indian economy to global, the strategic mergers and conducive environments help Indian companies to meet global challenges through mergers and acquisitions.

Objective of the study

The present paper mainly focuses on the following major objectives:

1. To Study different waves of mergers and their impacts on the economy,
2. To study the factors for the failure of mergers and acquisitions and
3. To review the success mantra for effective implementation of Mergers and acquisitions.

Materials and Methods

Tools for data collection

The data required for the study have been collected from various secondary sources such as research articles from journals, working papers, web sites.

Research type

Conceptual in nature

Limitations

1. Major data have been collected from secondary sources; there is a possibility for the manipulation of data.
2. The paper focuses only on Mergers and acquisitions, failure and success factors.

Discussion and results

Mergers and acquisition has a great history in the USA rather than in India. The waves of mergers are divided and analyzed by dividing them into different periods.

The First Wave of Merger And Acquisitions: 1897-1904: Most of the mergers are horizontal Mergers which indirectly created monopolistic Market structure. Mega merger between US Steel and Carnegie Steel. It has also helped to exploit the economies of scale. Small regional firms become national firms. The US President Theodore Roosevelt and President William Taft made a crack down on Large Monopolies by bringing the Anti Trust Act. Due to Stock Market crash in 1904 many banks were combined into Federal Reserve System.

The Second Wave (1916-1929): During this period Oligopolies industrial structure was created. Industries like primary metals, petroleum products, food products, chemicals are prominent industry prone for mergers and acquisitions. Heavy manufacturing industries and product extension merger like IBM and General Foods, vertical mergers in the mining and metal industries were part of this period. Between 1926 and 1930 there were 4600 mergers took place. As a result of which between 1919 and 1930- 12,000 manufacturing, mining, public utility and banking firms disappeared. In this period rail transportation, motor vehicle transportation became national market. Radios in homes, entertainment enhanced the competition, mass merchandising, national brand advertising. Investment Bankers played a vital role in the first two phases of mergers. Due to the Second World War small firms merged with larger firms and in fact, those mergers were small.

The Third Wave (1965-1969): Merger activity reached its highest level during this period due to booming of economy. Most of the mergers are conglomerate mergers. Federal government adopted a stronger antitrust enforcement both with horizontal and vertical merger. Due to which diversification strategy was followed by industries. Management principles were applied in industries. Management graduates were employed to manage conglomerate mergers. There were 6000 mergers during this period which leads to 25000 firms disappeared. Investment Bankers do not finance most of these mergers.

There was Equity financing to meet mergers. There were boom in stock market prices. Many conglomerate mergers failed. For example, the Revlon and cosmetic entered into health care and failed and suffered in cosmetic industry.

The Fourth Wave (1974-1989): There was a recession in 1974-75. There were hostile mergers during this period. In the first step, target on company's board of directors. If the board accepts, it is considered friendly, and if it opposes it, it is deemed to be hostile. The great mergers such as Oil companies amount to 21.6% of dollar values of merger and acquisitions during this period. Due to deregulations of drug, medical equipment, airline industries opted for merger. Investment bankers played an aggressive role. M&A advisory services became a lucrative source of income for investment bankers and developed innovation in acquisition techniques.

The Fifth Wave-1992- 2007: Once again there was increased activity in mega mergers in 1992 which are considered as strategic mergers and equity based. They were technological changes and deregulated. Majority of them are related to banking, telecommunications entertainment and media industries. High growth in banking sectors in 1990 as banks grew greater than central banks. Banks fund M&A rather than new ventures. Competitions are declined and globalization was the order of the day. Mergers are not confined to US companies. Some of the US companies were acquired by non-US companies.

Table showing the number of mergers over the period

Year	Number of mergers
1981	2395
1989	2366
1990	2074
2001	7528

Source: CFA, Indian Publication on Mergers and Acquisitions

In the year 1981 there were 2395 mergers and acquisitions. It had increased to 7528 in the year 2001.

Mergers and Acquisitions- Global Scenario

The merger waves in the USA has slowly spread over to South East Asia and created a reverse trend in mergers and acquisitions. Asian companies have acquired US and European companies. It also indicates that Asian economy becomes stronger and has capacity and ability manage foreign companies.

In China, Coca-Cola's bid for Juice maker Huiyuan was rejected due to the Chinese Anti-Monopoly law in 2008. Local government can be an obstacle to some deals particularly to protect labour intensive industries. Midea acquisition of Little Swan, a washing machine maker in Wuxi, led to labour strike due to firing of workers, the local government put pressure on the acquirer. Chinese companies completed 110 cross-border deals in 2011; more than half were foreign-funded deals. But behind each success acquisition, there are many more failures (Clare Chen, an analyst at Zero2IPO).

Chinese companies abroad have the world's highest failure rates even though the volume of foreign transaction is obviously increasing but it's worth nothing. Deficit of management talent at China's companies is one of the reasons for failure of TCL's joint venture with Thomson Electronics, then the world's largest manufacturer of television. Thomson people did not respect the Chinese at all and the result was disaster in merger and lost monetarily. Chinese companies look at the merger as strategy to strengthen brand and technology. The Chinese leading car company Geely chose to remain a passive shareholder after acquiring Volvo. After acquiring IBM's PC division by Lenovo, a computer maker from China moved its headquarters to South Carolina(USA). It is believed that there is a huge management gap between Chinese Companies and Western Companies irrespective of the monetary strength. Lie rightly said , "no matter how much money you have, you are still a student in front of the Western companies".

Mergers & Acquisitions in India

Due to license era unrelated diversification, , friendly takeover, conglomerate merger and hostile bids by buying equity shares are some the types of mergers in India in the last 40 years. For Example Swaraj Paul made an attempt to raid on Escorts Ltd and DCM Ltd but the attempt failed to succeed. The Hindujas followed negative technique and took over Ashok Leyland and Ennore Foundaries. Chhabria Group acquired stake in Shaw Wallace, Dunlop India and Falcon Tyres Goenka group from Calcutta(Kolkata) took over Ceat tyres, the Oberoi-Pleasant hotels of Rane group, Tata Tea acquired 50% of the equity shares of Consolidated Coffee Ltd from resident shareholders in 1989 are some of the hostile mergers. Hindustan Computers, Hindustan Reprographic, Hindustan Telecommunications and Indian Software Ltd. were merged to form HCL Ltd. TATA and Corus(Steel), Ranbaxy and Daiichi (Pharma), Global Trust Bank and Oriental Bank of Commerce (banking), HDFC and Centurian Bank of Punjab(banking), Indian Airlines and Air India(Airlines), Indian Oil and Russian Oil Company, Kingfishers Air and Air-Deccan, TATA acquired Land Rover and Ford Icon from Ford, National Carriers Air India And Indian Airlines, Lord Krishna Bank and Centurion Bank and Vodafone and Hutchison Essar are some of the mergers in recent times.

In 1997 Sun Pharmaceuticals, signed merger deal with Israeli major, Tara Pharmaceuticals which included an option agreement but Tara postponed the deal to avoid merger process and agreement failed.

Vodafone acquired Hutch outside India but luckily the Supreme Court rejected the contention of the Income Tax department to pay a fine of around Rs.15,000 crores. The recent mergers are strategic mergers. The leading mergers since 2006 are telecom sector. BFSI, Metals & Ores and Oil & Gas Sectors follow the suit.

Failure Factors Of Mergers And Acquisitions

Most mergers fail at the execution stage itself. The two cultures do not get along easily at an early stage of mergers but two talented minds are heading for the door. There are such instances, such as the marriage of HP and Compaq that are troubled from the start. More than two-thirds of transactions that fail do so at an early stage of execution. Daimler Chrysler, for example, neglected early on to establish a proper set of guiding principles based on strategic intent of merger, and misfired to align the leadership and integrate the cultures of the two organizations.

There are no set of rules for the implementation and success story of merging. Merging companies fail to develop a set of rules linked to the merger's strategic intent. Perfection may not be possible, but these set of rules will assure that all decisions drive the combined entity in the same direction. Ground rules for planning provide nuts-and-bolts guidance for how the planning teams should act as they begin to put the face of the merged entity in black and white. These rules should help for how decisions are to be made and how conflicts should be resolved.

Post-close transition plans can be lacking due to the daunting complexity of any integration such as the culture of the companies, a resistance to share information and top-down accountability and unwillingness to follow a methodical decision timeline.

All relevant stakeholder groups—both internal and external—must receive communication about the transaction, early and often. Management must strive to understand how these groups view the deal and how they might react to changes such as new pricing, vendors' elimination and adjustments in service and personnel.

Historical experience 1: Hp and Compaq: When Carly Fiorina was appointed CEO of Hewlett-Packard in 1999, it marked many firsts: the first outsider, the first woman, the first non-engineer, and the youngest person ever to head HP in its 60-year history. Six decades later, Walter Hewlett, an HP board member, votes “Yes” to the merger but immediately starts a campaign to stop it. With the support of other family members and the Packard Family Foundation, which in total own 18% of HP shares, the normally reserved Hewlett leads a fight that nearly puts an end to the highly publicized merger. In the end Fiorina wins, after receiving last-minute support from Deutsche Bank. Perhaps all would have proceeded smoothly if Fiorina had considered the concerns of the families before proceeding. They did, after-all, have large financial and emotional stakes in the company. The challenge of leadership when attempting to regenerate a highly regarded corporation is the significance of corporate culture in organizational transitions.

Historical experience 2: In India, Capt. Gopinath of Deccan aviation said that the merger of King Fisher and Air Deccan has to be approved not only by the two boards, but also by the independent directors, institutional investors and other shareholders. The four independent Directors on the Air Deccan board include former tennis star Mr. Vijay Amritraj, Prof Thiru Narayan from Indian Institute of Management, and Mr. A.K. Ganguly, former Managing Director, Nabisco, Malaysia.

Historical Experience 3: For the first time in its history, the President and Secretary of the ECIL Employees Union (EU) and the President and Secretary of the Officers Association (OA) were invited to join the Corporate Management Committee (CMC) of ECIL. They were invited to participate in deliberations of the committee comprising the Chairman and Managing Director, Functional Directors, Executive Directors and Heads of the Strategic Business Units (SBUs)-transparency levels rarely seen in any organisation. A `Mukha-Mukhi (face to face)' scheme was launched to enable direct communication between employees and the Chairman and Managing Director.

No Holistic Approach

Management must set aggressive targets from the start both for cost savings and revenue growth. Majority of companies tend to focus on one or the other—but neglect to place adequate emphasis on both.

Lack Of Financial Bench Mark

We have seen merging companies build detailed integration plans only to stop short of driving them into the combined entity's operating financials in a clearly identifiable manner. Short memory of Institutions and the plans are often redone. Integration plan should help in financial benchmarks which can track such plan of action.

Cultural Differences

Culture of a company can be identified through organizational structure and responsibility and accountability. There is a connection between group members shared language (method of understanding each other) and the way of representing the world and culture bringing disparate groups of people together as one company takes real and it is a critical aspect of any transaction (Schall 1983, Barley 1983, Hofstede 1984, Cremer 1993, laxear 1999). However, simply acknowledging the issue or handing it off to specialists may not solve the issues related to cultural differences.

Historical Experience:4 :In India, Kingfisher Airlines: Targets the well-heeled passenger and business traveler with promises of pampering customers with quality, full-flight service, while Air Deccan's vision is to empower every Indian to fly. Mixing everything in one company doesn't work. History is not on Mallya's side. Full-service carriers and low-cost carriers (LCC) belong to separate worlds, and their DNAs seldom match. Whenever they have tried to merge or work together under one umbrella, they have failed.

It happened when British Airways tied up with budget carrier Go, and when Delta Air acquired budget carrier Song. These two airlines have different cost bases and pricing strategies.

In the year 1994, Quaker Oats acquired Snapple Beverage Co. but, failed due to conflict between corporate cultures. Quaker had an extremely focused, mass-market working approach, whereas, Snapple focused on commercial and titled towards its distributors. Benz and Chrysler's merger failure is also due to cultural differences. Sprint and Nextel Communications is another example for cultural differences for failure. Sprint was bureaucratic and not much tuned to customer service, whereas, Nextel was entrepreneurial and customer oriented.

Communication

Management normally hesitates to share information and current regulations to employees and dependents before sharing such information to public. Rumors spread like wild fire which creates panic among employees and others who are dependent.

Difficult to understand the Indian Income tax and sales tax rules and regulations

There are tax experts and consultants to advise but failed to lead and guide mergers and acquisitions. Vodafone and Hutch merger were facing problems related to income tax, luckily, the Supreme Court of India cleared the hurdles. Sales tax regulations related to mergers and acquisitions differ from one state in India to another state in India. The companies land in paying sales tax twice/thrice if place of registration and the place of business situated in two or more States in India.

Right Person to Lead

Every company needs clear decision rights about who can change the agreed-upon plans, under what circumstances, and with what approvals. One key step is selecting the right person or people to lead the program integration team and track the plan's execution. In India, Air Deccan & Kingfisher airlines have decided to merge & create a new entity. Accenture, a management consulting firm, has recommended a merger of the companies for profitability & to cut costs. Mallya, the CEO of Kingfisher airline would have to be head of the company & Capt. Gopinath would be the vice chairman.

Historical Experience 5: Tata Pleases, Ford 'Disappoints' British Workers' Union: The head of Britain's largest workers union reiterated his support for Tata's acquisition of the luxury car brands Jaguar and Land Rover, but said he was disappointed by seller Ford's failure to retain a stake. Union officials would have liked to see Ford take a minority stake, as it did while selling off the luxury car Aston Martin to two Kuwaiti investment companies last year. Ford retained a \$77 million stake in Aston Martin.

Historical Experience 6: Merger Of National Carriers Air India And Indian Airlines: It has been challenged in the Bombay High Court on the ground that it defies Parliament's intent to keep international and domestic carriers separate. The petition filed by Air India Cabin Crew Association (AICCA) also questions the Constitutional validity of section 620 of Companies Act, which empowers government to exempt any government company from provisions of the Act. Air India Limited and Indian Airlines Limited were created by a Parliamentary statute, and, therefore, without the Parliament's nod they cannot be amalgamated, the petition contended.

Historical experience 7: Merger of Lord Krishna Bank with Centurion Bank: The affidavit was filed in response to a writ petition filed before the Kerala High Court, in India, by a minority shareholder, challenging the merger and seeking to appoint inspectors to investigate the

amalgamation scheme. Resolutions were moved one by one and arrangements were made for members/proxies to exercise their votes. The allegation that 65 per cent of the shares were held by a single entity was totally false. No person holding share in excess of ten per cent of the bank exercised voting rights in excess of 10 per cent. With the permission of the RBI, a person could hold more than 10 per cent of the share of a banking company but the right to exercise vote was restricted to 10 per cent of the total voting rights.

Historical experience 8: The French government pushed to make Sanofi and Aventis:

Due to interference of French Government Sanofi and Aventis come together but French officials placed phone calls to executives at the Swiss company on at least three occasions warning that Novartis should stay away. Afraid that Aventis, based in Strasbourg, France, would fall into Swiss hands, the French government had leaned on Sanofi Chief Executive Jean-Francois Dehecq to raise Sanofi's bid to improve the chances of an all-French deal. France's intervention in the takeover battle, against the free-market principles espoused by the European Union, Yet, in recent years, it has broken the union's economic rules more than once, giving state aid to ailing French companies, letting its budget deficit grow and thus contravening a pact that underpins the euro, and getting involved in takeover battles.

Historical experience 9: Vodafone and Hutchison Essar : The Court has sent notices to the Hutchison Essar's Managing Director, Mr. Asim Ghosh, and the Chairman of Max Group, Mr. Anajit Singh. The two individuals hold 12 per cent of Hutchison Essar, which is the bone of contention. The stake is being held indirectly by the two individuals on behalf of Vodafone. The sale-breached India's Foreign Exchange Management Act and also the licensing conditions for providing telecommunications services in India.

Merger and Anti Trust Act

Merger may have hurdles not only from within the organization but also from Antitrust Act or even by the elected government officials. Standard Oil in USA faced Antitrust intervention in 19th and 20th century. Canadian Competition bureau reported that the Royal Bank of Canada and the Bank of Montreal merger would result in substantial lessening competition in 104 out of 204 local markets. The European commission turned down international merger proposal between Cannada's Alcan and France Pechiney and Switzerland's Algroup. The U.S district court found that Microsoft was guilty of natural monopoly by combining internet browser with its operating system. The remedy is that breakup of Micro-soft into smaller independent companies. Canadian government restricts holding more than 10% of shares by any one shareholder in a bank which restricts foreign entry through the acquisition of the scheduled bank. The internal growth within a firm might attract the Antitrust Act. Antitrust had impact on Coca-Cola's acquisition of Dr. Pepper, Philip Morris to sell its Seven-Up soft drink unit to Pepsi and Google tried to acquire Yahoo. In China, Coca-Cola's bid for Juice maker Huiyuan was rejected due to the Chinese Anti-Monopoly law in 2008.

Success Mantra Of Mergers And Acquisitions:

1. Execution-related failures can be avoided provided you need to establish a program integration team early in the process that can respond to the execution risks inherent in all transactions. For instance, managers at the middle level were sent to various Godrej sites for training so that they could have a firsthand experience of systems and practices and such managers were playing as change agents.
2. The first step taken in the restructuring process was to establish clear channels of communication with the employees. They have to depend on the intrinsic strengths of the company rather than the external helps.
3. The board and management should have separate counsel during mergers to ensure unbiased advice and fair representation of shareholders views.
4. Build your targets with some stretch and expect that your people will find a way to get there.
5. Management must set a vision, align leadership around the cultural integration and hold substantive events to give employees a chance to participate. Detailed plan of action and well articulated expectations of change in behavior to inter-connect the culture plan to the business goals.
6. With proper planning and attention to detail throughout the merger process—from determining strategic planning and direction, transaction design, and post merger integration require dynamic leader to lead, execute and integrate.

7. Tell employees what you can and what you can't tell them at the moment, why, and when you will be in a position to do so.
8. Training to employees before merger: One company may have entrepreneurial and risk taking style of functioning. Other company may have extreme authoritative and procedural orientation. Middle level managers were sent to various Godrej sites (An Indian Company) for training so that they could have a firsthand experience of systems and practices and such managers were playing as change agents.
9. Carefully give importance to rename, logo, colour, check in counter, check in staff, redesign of the reception, rebranding, consultancy firm and the leader to lead the Jumbo.
10. Insure your post merger legal battles in India. Even mergers happen between two entities outside India can attract Income tax in India if there is a remote link with Indian entities before or after mergers.

Conclusion

There are many reasons to fail but a few reasons to Success of a merged entity. Failures are not stepping stones to success with respect to mergers and acquisitions. Definitely, everyone understands that if new software fails by even by 0.1%, the software fails by 100%. In the same way if merger is not successful by 100%, it is considered failure. The studies undertaken guide the management and persons involved not to fail to understand the reasons for pre and post merger failures. The government of India brought legislations under Income tax Act to encourage Indian companies to acquire companies outside India and multinationals taking over Indian companies by increasing foreign holdings in Indian companies such as insurance and telecommunication sectors. The acquiring company can set-off losses of the acquired company out of the operating profits earned and save tax. Understanding culture, training of managers to develop change agents, communication to stake holders, building targets, developing a new culture, leader to lead careful planning and implementation at each stage of mergers make merger successful.

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VIRTUAL CURRENCIES, MICROPAYMENTS AND THE PAYMENTS SYSTEMS: A CHALLENGE TO FIAT MONEY AND MONETARY POLICY?

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Abstract:

In this paper we explore the concept of virtual currencies, a concept that is fairly new not only to Economic Theory but especially to Monetary Dynamic General Equilibrium models with micro-foundations. From the perspective of the conventional wisdom associated with the design and implementation of monetary policy, we are used to models where currency takes one of two forms: it is either a commodity money, from which people derive utility, or a fiat currency, whose value is mainly determined by the people's beliefs regarding its future acceptability in exchange for goods and services. Either of them may arise as the legal tender in the economy, and they both operate in close proximity with our every-day physical environment.

However, the recent advances in electronics and telecommunications, coupled with the creation and expansion of social networks, micro-products, among other things, pose a challenge to the standard models of money. In many cases, these changes are associated with the creation of alternative and "virtual" realities that differ significantly from the standard physical environment of an Arrow-Debreu economy. This paper is a first and still incomplete attempt at closing the gap between these advances, their definitions and their implications for Economics as a science.

Key Words: Virtual currencies, Micropayments, Virtual goods, Digital goods, Micro-products, Social networks

Introduction

Our economic environment has been characterized by continual technological advancement, especially since the last decade of the 20th century; moreover, not only have these changes been abundant but they have also occurred at break-neck speed, causing significant alterations to the way in which we carry out our day-to-day lives. Without having to look exhaustively or in the farthest places of the globe, one could find any number of middle-aged individuals who can still remember the ordeal implied by telecommunications not so long ago. Just for illustration purposes, allow us to refresh your memory by mentioning a couple of examples: we were subjected to either very expensive telephone calls of below par quality that would disconnect without any warning, or we were supposed to print, cut and paste documents together so that they could be photocopied and later faxed to their destination.

The almost incredible speed at which all these changes are being thrown at us has not allowed us yet to take a step back to try to understand and comprehend the whole picture implied by them. Nowadays, we have virtual games that create virtual realities and need virtual currencies to function, together with digital goods that are traded electronically, as opposed to the standard physical environment with traditional brick-and-mortar stores that we are used to deal with in the Arrow-Debreu economies. On top of that, we also have many kinds of electronic purses and a variety of accounts that are needed in order to transact directly or indirectly in these virtual worlds or with digital goods. We must not forget to mention either the quickly expanding social networks, which create new necessities as well. Overall, we can hardly keep up with the pace of these innovations, and so we also struggle when trying to define these many newly created objects.

It is undeniable that we all feel overwhelmed in the middle of all this over-spreading novelty. In spite of this, but maybe also because of it, some of us think that maybe the time has finally come

when must take up the challenge of building a new class of general equilibrium models that are responsive to our ever-changing and complex reality. In particular, now it is the time for us monetary theorists to start moving gradually away from our standard monetary general equilibrium models, since the latter deal only with very limited kinds of currencies: they deal either with standard commodity money or fiat money in a regular physical environment. But our new reality needs more than that: to start thinking about virtual or digital currencies in virtual and/or digital worlds. Our Arrow-Debreu economies, as they are now, are not ready yet to allow us to respond to these new needs and worlds.

The empirics of common wisdom and the highly sophisticated intellectuals both agree that most of the above-mentioned changes have been concentrated on the sectors of electronics and telecommunications. We propose to start building upon three very simple ideas: first, that the emergence of virtual or electronic currencies is at the heart of these happenings and that it has been the oil lubricating its workings; second, all the events mentioned are something that our models cannot deal with yet; and third, that this is a multi-dimensional issue.

We are proposing, accordingly, to take our general equilibrium models one step forward, and for us, economic theorists, to move with them. But this must be done sequentially, little step after little step. We believe that this paper is a first step in this direction, where we propose to undertake a particularly important first task (that may not work out to be as simple as we would like): the immense undertaking of trying to come up with an all-encompassing definition of virtual/electronic/digital currency. We are aware that we are proposing to define something that we may not understand fully as yet, but this is also the beauty of this challenge. Moreover, we will follow our own advice and will be focusing mostly on the economic and financial aspects of this phenomenon at this stage; this is to be complemented later on with the legal and institutional aspects, which are equally important but are for now a bit out of our reach.

There is a notion deeply ingrained in every one of us and that comes up whenever we try to deal with the concept of a currency, whichever its form: one way or another, a currency is something that requires trust and a very high involvement by the government and related institutions. Keeping this in mind, we propose to start by mentioning these definitions as they are put in place by some “official” institutions. A first take on the subject is by the Financial Service Authority of the United Kingdom, who defines electronic money as follows:

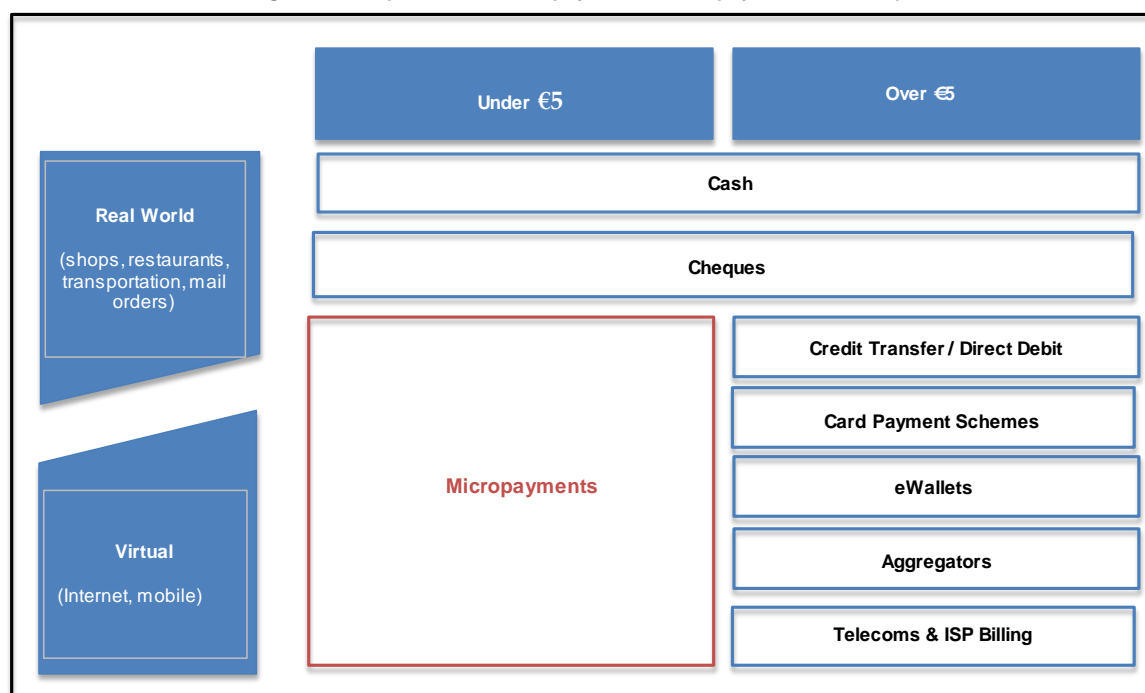
Electronic money (e-money) is electronically (including magnetically) stored monetary value, represented by a claim on the issuer, which is issued on receipt of funds for the purpose of making payment transactions, and which is accepted by a person other than the electronic money issuer. Types of e-money include pre-paid cards and electronic pre-paid accounts for use online.

Financial Services Authority.

We must be aware that assigning a value to the goods and services we wish to consume directly or that we use to produce other goods is, most frequently, expressed in monetary units, since one of the most essential functions that a money must carry out is to be a unit of account; i.e. we use the legal tender every day to value all of our transactions and things we care about. But nowadays we must also account for a new kind of money, which use is expanding rapidly: one can use virtual currencies that are redeemable in fiat money but not necessarily backed by it, as a representative currency would. The value of such transactions performed over the Internet has increased enormously: goods and services that before were purchased at “bricks-and-mortar” stores are now acquired over the Internet. Interestingly, these transactions mostly use electronic equivalents of fiat money (e.g. electronic funds transfers, debit cards or credit cards) as media of exchange. Moreover, the current forms of electronic money (including digital cash or stored value cards) have been engineered to operate in such a market.

Before getting started, we must lie out what we understand to be the most important issues related to e-commerce. Among them, we must highlight the definitions of micro payments, virtual currency, digital goods and virtual goods.

Figure 1. The position of micropayments in the payments landscape



ISP = Internet service provider

Source: Burelli et al (2011). Adaptations by the authors.

Regarding micropayments, we must say that the related technological advances have created a market for micro-products. The exact definition of what constitutes a micro-product varies widely by audience; and the differences arise from the defined monetary value below which we have a micropayment. To illustrate this wide variety, we must mention that this upper value varies from €1 (as in Innopay) to USD 12 (by PayPal). We must pick a value before moving ahead, so we will use the definition by [3]:

‘Micropayments’ is a term that identifies transactions of low value; however the exact definition varies considerably by audience. For the purposes of this report, a micropayment is defined as ‘an online or mobile, real-time or deferred, financial transaction below five Euros which initiates the instantaneous delivery of a digital good’. They can be used to charge customers on a purchase-by-purchase basis for a range of digital goods, including access to news content, online music, TV shows and films.

Burelli et al (2011), p. 9.

For the purpose of comparability, we transformed the value of €5 into US dollars, which is equivalent to \$6.5, and this cipher is attributed by [3] to The Economist. A couple of related definitions are those of digital goods and virtual goods. On the one hand, a digital good is defined by Webopedia as follows:

In electronic commerce, digital good is a general term that is used to describe any goods that are stored, delivered and used in its electronic format. Digital goods are shipped electronically to the consumer through e-mail or download from the Internet. Usually when you purchase digital goods online, after payment has been received the merchant will provide you with your digital item as an e-mail attachment or they may provide you with a secure link where you can download the item. Examples of digital goods include e-books, music files, software, digital images, Web site templates, manuals in electronic format, and any item which can be electronically stored in a file or multiple files.

Webopedia.

We must clarify as well that digital goods are sometimes labeled electronic goods in the related literature. We believe that it is also important to define a virtual good. As stated by The Computer Language Company Inc.:

Virtual goods are images of real things that are purchased to enhance online games and social networks. For example, players can purchase elaborate avatars to represent themselves, send an image of flowers to someone.

The Computer Language Company Inc.

For the sake of completeness, we must also define a virtual currency. As before, one could find many definitions, but we believe that they all complement each other. Wikipedia gives the following definition of virtual currency:

Virtual currency (or **in-game currency** depending on environment) is used to purchase virtual goods within a variety of online communities; which include social networking websites, virtual worlds and online gaming sites...

Some virtual currencies are time-based, relying upon measurement of in-game achievements in order to accrue exchangeable points.

The word (sic) **virtual currency** or **cyber currency** is also often used, in a more broad sense, to indicate electronic money, that is not contractually backed by tangible assets nor by legal tender laws, and which is not a tangible commodity itself. Examples are peer-to-peer crypto-currencies like bitcoin and the above mentioned in-game currencies that are backed by virtual goods.

Wikipedia (2012)

But we must also complement this definition by saying a couple of other things. First, there are examples of virtual currencies where their value is actually backed by tangible assets (as in the case of Ven). Secondly, a virtual currency can be issued either by a government or by private agents (like most cases). An example of the former would be Mintchips: it is a currency not in use yet but that will be issued in the near future by the Canadian government to substitute the use of small change. Mintchips are intended to cover micro transactions (with value below \$10) and nano transactions, (with value below \$1) [2]. Regarding examples of virtual currencies issued by private agents, we can mention (among many) Facebook Credits and Bitcoin. See Table 3 for a more complete list of examples of virtual currencies.

The remainder of the paper is organized as follows: section 2 details the nature of the transactions and the institutions that deal with micro-payments. Next, we present a brief review of the previous literature. In section 4, we present what we consider to be the main challenges that will be faced by monetary policy, and Section 5 concludes.

The Industry of Micropayment Services

There are many different definitions of what constitutes a micropayment, which mostly vary according to the upper limit of the price of each transaction. We believe that there is not a definition that is, a priori, better than the others, but we must pick one in order to move forward with our study. Thus, we have chosen, for the purposes of this study, to define a micropayment as an online or mobile transaction with a value below \$6.50. In the remainder of this section we will present what we believe to be the main characteristics of the micropayments industry.

In this paper, we focus our attention on some particular aspects of the micro-payment system, i.e.: the Internet payments system for the micro-products market. We start by describing the recent evolution of this industry. Next, we turn to describe the different niches in this market; we will focus on two: transaction grabbers [16] and virtual currencies (although we are aware that there are more niches, they tend to overlap in this two). We believe it is very important to describe not only the market niche of virtual currencies, but also the second niche labeled as transaction grabbers, highlighting the fact that transaction grabbers are, among other things, facilitators of the use of virtual currencies.

Let us summarize the recent evolution of the micropayment industry. Most of this section is based on Burelli et al (2011). The evolution of the micro-payments has been enabled by three mutually reinforcing trends, which we list below:

- a) The growth of broadband infrastructure and e-commerce

The Western European broadband penetration has grown from 19% of households in 2004, to 56% at the end of 2009; in addition a further 9% of households have access to mobile broadband. Building on this, widespread consumer adoption of online payments has fuelled considerable growth in global e-commerce. This behavioral shift, supported by a thriving online payments industry, has increased online spending from £150 billion in 2004 to over £350 billion in 2009.

The authors highlight that online shopping is so popular that even in the global recession of 2008/09, as UK high street retailing revenues contracted by approximately 2.5%, online sales rose 17.8%, compared year on year. Moreover, a survey of U.K. consumers showed that more than two-thirds of the population aged 14 or above bought goods and services online in 2010.

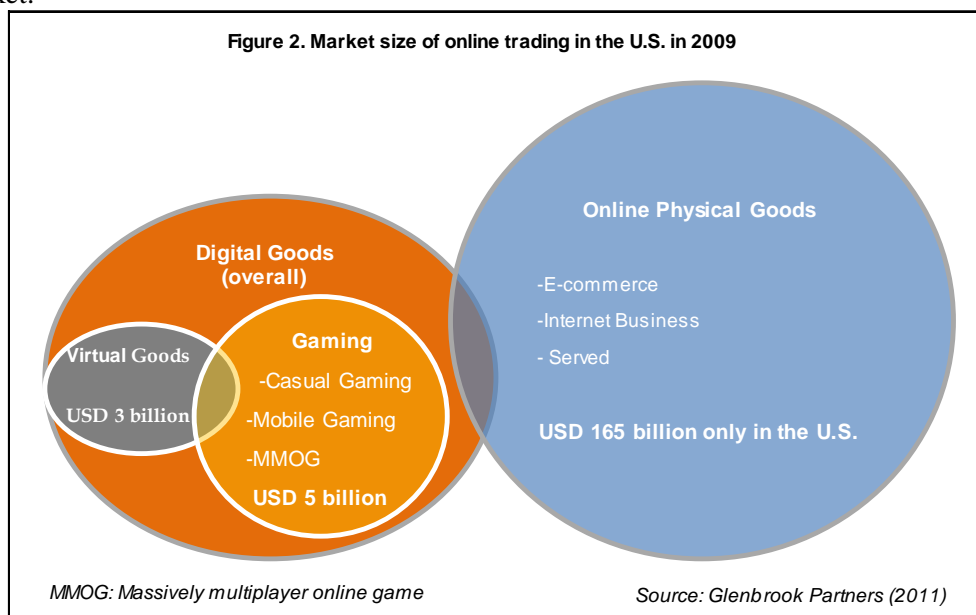
b) The growth of social networks, online gaming and virtual goods related businesses

The online gaming sector has rapidly gained popularity among Internet users. The period 2007–2009 saw a proliferation of online games with built-in virtual currency systems and virtual goods stores. Currently, these systems attract over 400 million active users every month. The use of these online games has been driven by integration into social networks. For example, FarmVille, a game designed by Zynga, is accessed by more than 63 million active users who each month spend an average of 15 minutes a day in the game.

Typically, virtual goods are bought for small sums of money within online games and are supported by a range of micropayment-style processes. For example, Facebook introduced their own virtual currency, called Facebook Credits, in mid-2010, which can be used to buy virtual gifts or spent within applications. In 2011 the overall market for only virtual goods in the US was headed towards \$2.9 billion for 2012, against \$2.2 billion in 2011, and \$1.6 billion in 2010.

c) The emergence of new online payments services and user interfaces

Value Partners estimates the European micropayments market was worth €6 billion in 2011, and is set to grow to over €15 billion by 2015. The use of electronic equivalents of fiat money became excessively costly, especially because of the size of the fees charged relative to the value of the micro-products. What seemed to be a serious problem in the micro-product market was the presence transaction costs so high that precluded very small transaction values: the currency available was not divisible enough, because it could not be used for transactions of value below the transaction costs [21]. The presence of these indivisibilities precluded some trade in this market.



Reducing the scope of these indivisibilities by introducing a new electronic medium of exchange that is cheap and accepted in different Internet communities has proven to improve social welfare. As comScore Inc. indicates, 29.7% of social gamers do not have the ability or the means to pay for virtual currency with cash options [15]. Companies like Google, PayPal and Amazon have leveraged their respected brand names and established trust-based customer relationships to enter the financial services market, while incumbent payment and banking infrastructures have increased their reach and new entrants are trying to establish themselves. Even so, according to Osama Bedier Google’s vice president of payments and of Google Wallet, only about 7% of retail sales occur online, compared to the 93% that is still spent in person at stores [43].

Consumers and merchants are driving the alternative payments market as they look for new ways to pay and get paid. Mobile commerce has lowered the costs for merchants to accept old and new

types of payments. Take Square, founded by the creator of Twitter, lets people accept credit cards with their smart phones.

The parameters that we will take into account for analyzing the examples that we mention below are based on Burelli et al (2011), and they are displayed in detail in Table 1.

Table 1. Parameters for assessment for virtual currencies and transaction grabbers

Payment functionality that supports many digital content providers that may be available also for either on-line or off-line payments across multiple retail industries.	Openness Open- Closed ← O - C →	Payment functionality that supports one or very few digital content provider(s) and works in a closed transaction environment.
Transaction funded on the base of an instant, real-time transaction.	Payment finality Real Time -Both- Pre Paid ← RT B PP →	Transaction enabled by advanced deposit of value prior to the transaction.
Transaction denominated by monetary currency value.	Type of currency used Real money ^{a/} - Virtual Currency ← RM - VC →	Transaction denominated by units other than monetary currency.
Settlement of micropayment transactions made on a one-by-one basis.	Rule for settlement Single Payment- Aggregator ← SP - A →	Settlement of multiple micropayment transactions that are processed in an aggregated manner.

^{a/} This refers to actual fiat legal tenders.

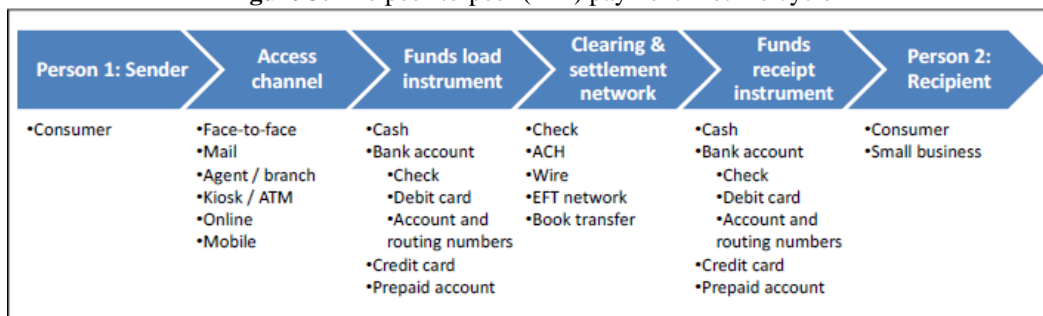
Source: Burelli. et al. (2011). Elaborated by the authors.

In the next two sections, we present a detailed description of each of the market niches of the micropayments industry.

The Transaction Grabbers

In the first niche, we find micro-payment companies playing the role of intermediaries between senders and recipients of money; we will call them the transaction grabbers; mainly they all work like peer-to-peer payments systems, as in Figure 3. Table 1 presents the cost structure of some of the existing electronic payments systems and Table 2 presents the way that these systems normally work. According to InvestingAnswers, peer-to-peer payments systems (P2P) are an online technology that allows customers to transfer funds from their bank accounts and credit cards to another individual's account via the Internet or a mobile phone. We think one shall include as well pre-paid accounts or other sources of funds.

Figure 3: The peer-to-peer (P2P) payment lifetime cycle



Source: Windh, J. (2011). Surveying a rapidly changing landscape.

For example, PayPal introduced their micropayment product worldwide in 2008. PayPal is a Web-based application for the secure transfer of funds between member accounts. There is no application fee for the user, and also there is no cost for sending money through the service, but there is a fee structure for those members who wish to receive money. That fee is still high for products with prices around $\text{€}5\text{-}\text{€}10$, that is why they release a special micropayment service, and also in July 2011 PayPal bought Zong for \$240 million, one of the main reasons was to attract this market on a full scale. Zong allows you to pay for purchases from your mobile phone or computer by adding the payment to your wireless bill. Zong verifies your wireless phone number and account, and clears the payment on your mobile phone bill: there is no credit card number, expiration date, nor billing address to enter [45]. They charge a transaction fee of 5-10% depending on the volume of the sale, without setup or monthly fees.

Table 2. Main characteristics of transaction grabbers

Transaction grabber	Application or set-up fee	Monthly fee	Transaction fee charged to the recipient	Openness	Payment finality	Type of currency used	Rule of settlement
Zong	None	None	5-10% transaction fee	O	RT	RM	SP
Payclick (only for Australia and some cities in the U.S.)	Not revealed until applying	Not revealed until applying	Not revealed until applying	O	B	RM	SP
PayPal	None	None	$\text{€}5$ plus 5% for micropayments (i.e. transactions under \$12)	O	B	RM	A
PayNearMe	Around \$199*	Around \$1,199 (annual)*	<ul style="list-style-type: none"> • Standard fee of \$2.99 for cash payments up to \$300*. • \$3.99 for payments ranging from \$300 to \$500*. • \$4.99 for payments up to \$1,000* 	O	RT	RM	SP
Dwolla	None	None	<ul style="list-style-type: none"> • No fee for transactions up to \$10. • $\text{€}0.25$ for all transactions above \$10 	O	RT	RM	SP
Google Checkout	None	None	Based on the value of monthly sales: For less than \$3,000: 2.9% + \$0.30 per transaction. Between \$3,000	O	RT	RM	SP

			and 9,999.99: 2.5% + \$0.30				
			Between \$10,000 and \$99,999.99: 2.2% + \$0.30				
			Above \$100,000: 1.9% + \$0.30				

* This information does not appear in the official PayNearMe website.

Source: official websites.

Visa launched their own micropayment system in Australia in 2010, which was called Payclick, and it is similar to PayPal's micropayments product, the system just asks you to fill in your password and the transaction is done, they do not reveal their fees until you apply for the account (this means give information about your business) but they claim to be very competitive. Visa has recently declared their interest in opening Payclick in the U.S. and Europe as well.

Almost all the transaction grabbers share the common characteristic that they do not require the clients to reveal their financial information at the time when the transaction is made, since doing so would be involve more risk and it would also be annoying if the client would have to do this on every purchase for only a small quantity of money.

Virtual Currencies

The second niche is occupied by virtual currencies. Its main use is to buy virtual goods in online games, social networks and massively multiplayer online role-playing game (MMORPG). On the one hand, Facebook credits are an example of virtual goods in online games and social networks (their value as today is 1 credit for 0.10 USD). On the other hand, Linden Dollars in Second Life is an example of virtual currency that works in a MMORPG. The growing mass of online gaming and social networks has facilitated the rapid increase in the global virtual goods market. Players of online games and members of virtual communities are spending more and more on virtual goods to enhance their gaming experience. In 2010, Europeans spent over \$1 billion on virtual goods, the Asian market is already worth over \$5 billion annually, and Americans will spend over \$2 billion by 2011 [3]. Their growth will continue as it is becoming easier and cheaper to be a part of this market.

Some virtual currencies are exchangeable for other virtual currencies and a few for fiat money, you can purchase them by the payments services explained above and/or trade them at web sites like Virwox or First Meta Exchange. Because there are ways to create wealth in these virtual worlds and online games, this opens an interesting area of business to study. For example, players of Entropia Universe (an MMORPG) already exchange real money for a virtual currency. And virtual money they make in the game, through virtual hunting, mining, trading or other activities, can be cashed out into real money. The virtual currency Project Entropia Dollars has a fixed 10-to-1 exchange rate to the U.S. dollar. Credit card companies are aware of this, for example, American Express bought in 2011 a company called Sometrics, which in 2010 did 3.3 trillion units of virtual currency on their platform. You can buy virtual goods such as gold coins or whatever it may be. That acquisition let the company tap into the massively growing space of online gaming and to develop capabilities to manage virtual currencies, a business that is projected to nearly double by 2014 [25].

One should notice two things about virtual worlds: in the first place, they have no measure to control money supply. The balance between goods and money is determined by collective consumption/saving decisions by players. Secondly, there are no interest rates in virtual worlds in general. The absence of interest rates, ceteris paribus, reduces incentive for saving and raises that for consumption. Since many virtual worlds do not have inflation of the general price level, we cannot say in general that consumption is preferred in virtual worlds relative to the real world. Nevertheless, still there should be greater incentive for consumption compared to the case in which there are interest rates [51].

There are other types of virtual currencies that work directly in the global economy. For example, Bitcoin; defined by its creator as a purely peer-to-peer version of electronic cash that allows

online payments to be sent directly from one party to another without going through a financial institution [30]. The main challenge for developing this kind of currency relied on the “double spending” problem. According to [26], [10], Bitcoin’s solution was to ensure that each coin was its own certificate of authenticity. As soon as a transaction takes place, the recipient publishes the transaction to the global Bitcoin network. Now every Bitcoin user has evidence that the coin has been spent, and users will only accept that coin from the new owner. Also, Bitcoin is almost 100% anonymous. “In the Bitcoin system, a new coin is produced whenever a computer can calculate an answer to a difficult problem, and then attaches that answer to a digital record of every transaction of every Bitcoin ever traded” [10]. Anyone is free to create a new coin, within proscribed supply limits, by providing computer power that helps to prove that it was in fact a valid Bitcoin. Bitcoins can also be traded for dollars and they are accepted in different online retail stores and also in a few “bricks and mortar” retail stores and cafés (for the list of the different currency exchange business, and stores that accept Bitcoins, visit Bitcoin Wiki web site). Also its target market is not only digital and virtual goods you can also obtain physical goods in some retail business. In 2011 there were seven million of these “coins” in circulation and the rate of increase—currently 50 coins are added every 10 minutes—will slow each year until the number tops out at 21 million coins around 2025.

Another example is Ven currency: The value of Ven floats against other currencies and the price is based on a basket of currencies, commodities (like gold, silver, Brent crude) and carbon futures which intends to make the value of this currency very stable because no single unit has a strong influence relative to the other influences in the basket. Also, the introduction of carbon to the basket is to support and stimulate demand for carbon credits and social impact development, driving offsets for every transaction used with Ven. At the moment \$1 is equivalent to 9.35 Ven. Ven trades against other major currencies at floating exchange rates and is mainly used in an online community called Hub Culture a site when members can trade goods and services as well as knowledge. Nevertheless you can also use it in Pavilions (retail places specially developed to accept the currency). According to At the beginning of the present year over \$100 million in assets were available for purchase in 130 hubs worldwide using Ven [40]. As opposed to Bitcoin, Ven does not provide anonymity, and is generated centrally (though exchanged).

Nevertheless, almost all of today’s existing electronic currencies (with the exception of Bitcoin and Ven) are surrogates of fiat money: they are denominated in fiat currency, and their purchasing power fluctuates with the purchasing power of the denominating currency. Moreover, except for Bitcoin, they are fiat in the sense that there is no backing of these electronic monies, and thus they are not redeemable to the issuers. For example, Avios is a currency that you accumulate for traveling on Iberia airplanes and that you can trade for traveling tickets and some products in partners’ stores; one may also transfer Avios to other Iberia clients as gifts or one could buy them, but they are not redeemable in fiat money. The exchange rate between Avios and euros depends on many things. First, the exchange rate is different whether you are purchasing or transferring Avios; second, there are economies of scale since the euros you pay increase less than proportionately to the amount of Avios traded (for example 2,000 Avios are worth €54 and 8,000 Avios represent €164).

On the one hand, since Avios only works for 3 airline groups (Iberia, Vueling, British Airways) and a limited retail market, it will not likely become a generally accepted transaction medium: people who are not interested in their offers may not value them at all, and might not want to accept Avios currency.

On the other side of the spectrum, we have the case of the Facebook credits: because Facebook is a most popular company, it is easy to imagine that such a currency would be more generally accepted than others. Until now, Facebook credits could mostly be used to buy virtual goods inside online games and some digital products like movie rentals. Nevertheless, Facebook have started an initiative called Deals that makes users able to purchase a voucher that is redeemable for real goods. According to [19] “Mark Zuckerberg, Facebook’s chief executive, said recently that the company may choose to do ‘a lot more’ with Credits in the future. Over time, the company plans to turn Credits into a system for micropayments that could be open to any application on Facebook, be it a game or perhaps a media company, people with direct knowledge of Facebook’s plans said. They spoke anonymously because plans have not been announced publicly”.

There are several advantages of this kind of virtual currencies: its value would not fluctuate with the value of fiat currencies, but instead it would depend upon the value of the commodity bundle

backing it and/or maintaining its reputation as an issuer. This type of electronic currency has its similitudes with commodity money it is now the product bundle that serves as the anchor. This new form of electronic money has the potential of being a currency with more stable value than fiat currency [21]. In addition, a global Internet currency would eliminate the need of foreign exchange. This is also why the issuer of such a currency should be a firm that is world-wide recognized, like Facebook (that it has a user base of some 800 million people worldwide).

Hernandez-Verme et al (2004) claimed that three technical elements are necessary for any virtual currency to be accepted by the public: low cost, security, and privacy. In particular, these authors highlight greatly the importance of low costs in micropayment transactions, practically regardless of the payment method utilized. They also point out, nonetheless, that there exist alternative ways of reducing costs; in this regard, they emphasized the importance of the avoidance of expensive intermediaries, such as banks and credit card associations, in this kind of transactions, since they could act as an indivisible sunk cost that may reduce the firms' margins and their profitability within the network. According to [27] p.3 "... about 2.5 billion people in the world do not have access to a bank account", because of this some of them are out of these kinds of markets. Security plays an important role in generating trust in an electronic environment: security becomes a must for electronic payments, where cryptographic security mechanisms, including encryption and digital signature schemes, are often used to provide the desired security for the transactions. Finally, privacy, the third element of the list, has become a much bigger concern in today's information world; so much so, that an ideal virtual currency should provide anonymity or at least a high level of privacy so it can compete against fiat money [21].

Table 3. Main characteristics of virtual currencies

Virtual currency	Openness	Payment finality	Type of currency used	Rule of settlement	Exchange Rate in USD (selling price)
Bitcoin	O	RT	VC	SP	\$10.87 for 1 BTC
Ven	C	RT	VC	SP	\$1 is equivalent to 9.35 Ven
Avios	C	RT	VC	SP	Depends on how much Avios you buy. For example 2000 Avios are €54 and 8000 Avios are €164
Project Entropia Dollars	C	RT	RM	SP	1 credit for .10 USD
Linden Dollars	C	RT	RM	SP	280.1 L\$/USD
Facebook Credits	C	PP	RM	SP	1 credit for .10 USD

Source: official websites. Elaborated by the authors.

1

Notice from Table 3 that Bitcoin satisfies two of the three characteristics mentioned above: it has low cost and it is anonymous, but it has a bad reputation for its safety and has been victim of speculation, this has caused that its exchange rate fluctuates unpredictably over time. In table 4 we provide an historical review of the exchange rate of Bitcoin. One reason could be that, as according to [38] p. 14 "In the United States and Europe, Bitcoin's meteoric rise was mostly driven by speculators; hardly anyone used the currency to actually pay for goods and services".

Table 4: Historical exchange rate of bitcoin as traded by Mt Gox
(USD per unit of Bitcoin at the closing time of the day)

Date	Exchange rate	Important event
04/25/2010	¢0.3	Bitcoin trade publicly for the first time (1,000 go for 0.3 cents each).
02/10/2011	¢0.98031	Bitcoin receives a write-up on Slash-dot for achieving dollar parity.
04/20/2011	\$1.1421	Forbes publishes “Crypto Currency” a profile of bitcoin.
06/01/2011	\$9.57	Gawker runs a story about Silk Road, an online bazaar of illicit goods that accepts bitcoins.
06/09/2011	\$28.919	Bitcoin reaches its peak value.
06/19/2011	\$17.51	Mt. Gox, the largest bitcoin exchange admits its database was compromised and user information leaked.
07/29/2011	\$13.49832	Wallet service MyBitcoin. Com becomes inaccessible; six days later, it comes back online with 51% (roughly \$250,000) of its bitcoin holdings missing.
11/18/2011	\$2.04999	Bitcoin exchange rate falls dramatically.
01/04/2012	\$4.8808	Bitcoin exchange rate starts to grow again.
08/12/2012	\$ 11.67001	Latest exchange rate.

Sources: Bitcoin Charts and Wallace, B. (2011).

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Benefits and Disadvantages of Virtual Currencies

In this section, we present a summary of what believe to be some of the pros that an “ideal” virtual currency should have to be widely accepted, together with the cons that it may find along the way. It is crucial to take each of the elements in this list into account for a proper analysis of existing virtual currencies; but it is equally important to consider them when designing the main characteristics of prospective virtual currencies. This part of the paper was mostly based in [1], [15], [38], [47].

The Benefits of Virtual Currencies

Below, we list what we believe are the advantages that an ideal virtual currency shall possess:

- Allows almost anybody to buy goods online without the need of using a credit card or disclosing private information.
- Acts as a substitute currency allowing customers to buy, sell, and trade items without having to use real world money.
- Provides anonymity or privacy to a point.
- Allows users to generate revenues and create profits online, which can then be exchanged for other goods (real and virtual).
- Reduces cost of entry to the market.
- Issuance is decentralized or centralized but only in the case that is from a private issuer that cannot induce inflation (like Ven).
- Distributed middleman or no middleman.
- Faster transfer than banks.
- Always available and instantaneous.
- Ubiquity.
- Good reputation of the issuer.
- Recorded in a public ledger.
- Solves the double-spending problem, encrypted transactions and friendly -fraud immune.

- Safer and better store of value than fiat money.
- Expandable and divisible.
- Deflation/Inflation Hedge. According to [16] "...the potential for fiat currency de-valuation or appreciation in the face of mounting debts and uncontrolled deficit spending has given everyone with significant wealth an interest in finding a liquid, hedge to the big three (dollar, yen, euro). Gold has been the traditional favorite in this spot, but with gold prices soaring and the threat of a bubble looming....the need for alternatives is strong".

The Drawbacks of Virtual Currencies

- Vulnerable to system failures.
- It could be used to pay for "illegal" activities or products, such as money laundering or buying prohibited products or services.
- Its valuation can fluctuate in some cases.
- Difficulty for making futures contracts or floating against fiat currencies (with the exception of Ven).
- Risk of Unknown Technical Flaws.
- Not accepted for paying taxes or as bank reserves.
- Decentralization is both a curse and a blessing, since there is no valuation guarantee. Since there is no central authority governing, no one can guarantee its minimum valuation. If a large group of merchants decide to "dump" virtual currency and leave the system, its valuation will decrease greatly which will immensely hurt users who have a large amount of wealth invested in this currency [1].

Notice that most of the disadvantages listed above are not particular of virtual currencies: historically, fiat currencies have also been used for money laundering and the financing of illegal activities –such as illegal drug dealings; but, because of their lack of intrinsic value, fiat currencies are prone as well to speculation, and particularly to the kind of self-fulfilling attacks that make their value fluctuate without any noticeable alteration in the fundamental of the economy; finally, we must also keep in mind that both inflation or hyperinflation crises might hinder severely the acceptability of a currency and the credibility of the government in general, and of monetary authorities in particular.

Review of the Previous Literature

Two of the most important papers about the potential effects of private money are Williamson (1999) and Temzelides and Williamson (2001). They both used a random matching model of the foundations of money for economies populated with infinitely lived agents. Among their results and recommendations, they emphasized that transaction costs, informational frictions, and related factors are the main causes explaining the discounts observed when trading different private currencies (most of the virtual currencies can be seen as private electronic currencies). The private money they study is a surrogate of fiat money that takes the form of a medium of exchange issued by financial intermediaries. However, according to Hernandez-Verme et al (2004):

... However, as argued convincingly by Schreft (2001), even though the models offered by Williamson (1999) and Temzelides et al (2001) are a good representation of how the financial system worked during the 19th century, they do not provide a clear insight on how a modern system of private electronic money would work and how the necessary network shall function. Moreover, these models are clearly not designed to address the problems faced in the micro-product market.

Hernandez-Verme et al (2004), p. 4

Nevertheless Temzelides et al (2001) did address the importance of restudy private money systems because there are fewer government impediments to private money issue and advances in information technology now permit private money systems where private liabilities are electronically transferred rather than by way of a physical medium of exchange thus it reduces the cost of operating a private money.

Williamson (2004) explored the implications of private money issue for the effects of monetary policy, for optimal policy, and for the role of fiat money. He uses a locational model and finds that when private money issue is permitted it changes dramatically the nature of optimal monetary policy. With private money, fiat currency is no longer used in transactions involving goods,

but currency and central bank reserves play an important part in the clearing and settlement of private money returned for redemption, because private money has the advantage of being “elastic,” in that its quantity can respond to unanticipated shocks in ways that the stock of fiat currency cannot. In this model private money is redeemable in outside money instead of commodity money (either gold or silver), which was a common feature of historically observed private money systems.

Schmitz (2005) gives a general critique to some of models of electronic and private money and concludes that the method of institutional analysis is the appropriate conceptual framework to investigate the impact of the diffusion of electronic money on the efficacy of monetary policy and the future of central banking; and that existing models do not particularly take this into account. He states that the analysis of recent and long run institutional change in payments systems demonstrates that its main drivers are politico-economic factors and demand of commercial banks and final customers rather than technological innovations. Although he does not propose a model his contribution is important because he raises the question of how much weight does technological innovations have in monetary policy evolution.

Micropayments systems are not a simple market to study or develop since most of them exhibit two-sided network effects. According to Rochet et al (2004) p. 2 “Two-sided (or more generally multi-sided) markets are roughly defined as markets in which one or several platforms enable interactions between end-users, and try to get the two (or multiple) sides “on board” by appropriately charging each side”. See-To et al (2007) found that the underlying dynamics of these two-sided markets are not very well understood and this may lead to the mixed results of various micro-payment initiatives. They concluded that a “survival mass” of merchants and consumers is required for the market to exist and a “critical mass” for the acceptance levels to take off and remain stable. The survival mass is completely determined by the normalized cost of adoption. The critical mass is higher than the survival mass due to two-sided network effects. Merchants will not adopt the system unless there are enough consumers who use the system. At the same time, consumers will not consider the system until there are enough adopters on the merchant side. Thus, the value of a micro-payment system to a consumer increases as more merchants adopt the system. Similarly, the value of the system to a merchant will augment as more consumers are willing to transact with the merchant using the new electronic means. They use anecdotal evidence to reinforce their conclusions, they compare the failure of initiatives like Mondex and Visa Cash with the success of the Octopus Card in Hong Kong, the latter was originally introduced to the public in 1997, targeting a public transportation market with 10 million passenger journeys per day. Octopus card system has been growing almost ever since its appearance to support non-transportation micro-payment transactions too because it quickly gained a critical mass. We need to take to account that this analysis was made when new technologies that make transaction costs cheaper (like mobile payments) weren’t develop as today, so that could be another cause of the failure of the first initiatives like the Visa example mentioned above.

Edward Castronova (2001) is the pioneer in analyzing economies of virtual worlds in MMORPGs from an academic perspective. He analyzed the economic activity in the virtual world “Everquest”. In Castronova (2003) he proposes a model with a utility function that differs substantially from ordinary ones, but what an economic agent does in the model is not so different. According to Yamaguchi (2004) in the model of Castronova (2003), avatars are like goods, and an economic agent purchases the avatars by spending time instead of money. The utility maximization through allocation of time to avatars is in essence the same as that through allocation of money to goods to consume. In Castronova (2008) they show the results of an experiment of massively multiplayer online gaming called “Arden: The World of Shakespeare”. They documented that people in fantasy games act in an economically normal way, purchasing less of a product when prices are higher, all other things being equal. This finding may open the way for future study in synthetic worlds of real economic behavior, he gives a very good insight of how virtual worlds can be studied from on the same basis of the “real” economy. Another paper of virtual currencies is the one of Irwin et al (2005) he proposed a self-recharging virtual currency model as a common medium of exchange in Cereus, a computational market for community resource sharing. Self-recharging means that the purchasing power of spent credits is restored to the consumer’s budget after some delaying effect, the credits recharge automatically, ensuring a stable budget but bounding the opportunity for hoarding. The purpose of self-recharging currency is to eliminate reliance on fragile mechanisms to recycle

currency through the economy. A community admits members based on their identities; in return for the benefits of membership, members submit to accepted standards of behavior within the community. Community resource sharing in Cereus is accountable: actions taken with a member's identity are non-repudiable, and members are subject to auditing and sanctions for misbehavior, including forfeiture of currency or ejection from the community. Similar to Castronova (2008) he concludes that alternative currency models can help to harness market principles as a technology for flexible, robust distributed resource allocation, enabling market-inspired systems that are simpler, more stable, more predictable, and/or more controllable than real-world economies.

The Future of Monetary Policy

Electronification and the use of alternative means of payment has been growingly at tremendous speed over the years changing the incentives and costs structure underlying particular institutional arrangements in payment systems. Thus, the ratio of central bank money to total value of payments has decreased considerably. This development gives rise to concerns about the future role of money and the central bank. Although we are still far from living in a cashless society, the role of monetary policy is in the verge of changing dramatically, especially because of two elements: a) the falling use of cash as a form of payment and b) the changes of regulation.

a) The falling use of cash as a form of payment.

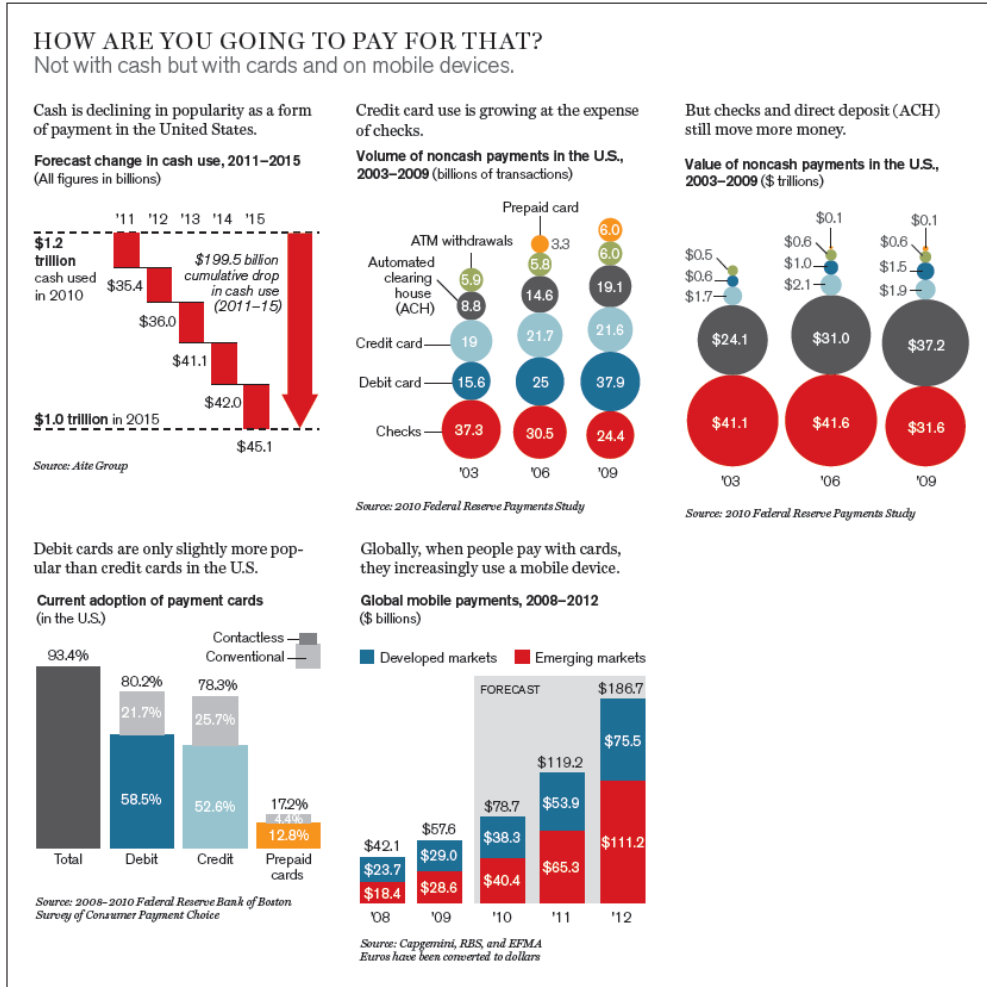
The use of cash as a payment method has been clearly decreasing over the years and it has been substituted by cards, mobile devices and alternative means of payment like the ones described in this paper. According to [37] p. 63 "The costs of handling cash are high compared to that of electronic money. Printing, distributing and controlling cash are estimated to cost approximately for a developed economy 0.75% of annual GDP and an emerging economy 1% to 2%. Social savings of using electronic micro-payment means over cash are substantial."

The role to be played by the central bank in the near future will be as important as it is today, and will remain the same for quite a while, almost all of new payment instruments in the retail payment market (e.g. electronic bill presentment and payment; person-to-person payments via PayPal; stored value prepaid cards; phone-based payments) are linked to the banking system and eventually settle in central bank money [35]. The demand for virtual currencies that are not denominated in fiat currencies is still low, but is increasing at such a pace that is important to improve the way that we study them. The existence of private monies is hardly new, but technological innovations could lead the way to a world where private monies have an important role in the world economy.

b) Regulation

Money and banking are highly regulated improvements on technology in the payment systems so they have a slow effect in the change of them policies. According to [27] p. 3 "... the intricacies of regulation make it difficult for banks to be truly customer-centric".

Figure 4: The declining use of cash in the U.S.



Source: Pontin, J. (2011).

According to [35], in recent history central banks have demonstrated their determination and their political ability to maintain control of the monetary system in the face of institutional change in the payments system and to actively shape. They have a large range of instruments at their discretion to react to but also to influence institutional change in the economy-wide payment system, they can adapt the instruments of monetary policy implementation and their own payment systems policies to cope with institutional change in the payments system. Changes in the reserve-maintenance system of the generally accepted medium of exchange (GAME) are of particular relevance in this respect (i.e. the averaging of minimum reserve requirements, the averaging period, its relation to the interval of central banks' refinancing operations and the potential employment of minimum reserves for settlement purposes). Actually, you can only pay your taxes with fiat money, and virtual currencies do not allow you to create a positive return by saving or lending (other than to your friends, like at RipplePay) or making futures contracts at a large scale, and, thus, fiat money will stay around the map. Nevertheless, is important to improve the way we study this markets for developing the appropriate banking policies. One example on how far we still far from adapting to this alternative means of payment is the fact that almost all virtual currencies are not taxable. The profits you make online can be converted into real monies without tax deductions.

Conclusion

The analysis carried out in this paper attempts to provide readers with an important insight of the list of tasks that are ahead of academic researchers in furthering their study of both virtual currencies and the micropayment systems. It intends to reach a more unified way to use the definition of virtual currencies, micropayments and virtual and digital goods.

Modern transaction grabbers have facilitated the emergence of virtual currencies by lowering costs of entry to this new market and making this alternative means of payment easier to manage. Virtual currencies are still in an early stage of development; as of now, they mostly work in the micropayments market for virtual goods. But the impressive growth of this market's size and scope, like in the case of Bitcoin and Ven, foretells that sooner or later they will have a crucial role in the design and implementation of monetary policy and on the future discussions of the political and economic agenda.

The potential benefits that these monies may provide are something we cannot ignore, since although they are not perfect, many of their defects are also similar to the ones presented in fiat money. A smaller role of the central bank should not be something to be "afraid" of as in [11]:

Time and again, banks have been willing to increase their portfolio of mortgage loans in response to higher real estate prices. These higher real estate prices, however, have often been caused by excessive money creation. This has often led to bank crises and collapses. In the absence of a central bank this feature of private banking could go on unchecked".

Costa et al (2001), p. 9

It is plausible that the generalization of alternative ways of payment could also prevent central banks on acting in an irresponsible way, for political purposes.

We must point out that there is a significant dearth of academic studies related to these emergent currencies. Among them, the work by Schmitz (2008) presents an interesting proposal for studying the effects or the arising of these currencies on monetary policy, from an institutional perspective. Also, the works by Castronova provide a helpful way to study the way that virtual currencies are used inside virtual worlds and online gaming.

It seems crucial that academics and banks reconcile the benefits of a world with both fiat and virtual currencies and try to find ways to integrate physical cash into the electronic world; the former should start changing some aspects in the modeling of monetary policy, and the latter must change their former structure in a way that allows people to take full advantage of this novel means of payment.

Acknowledgments

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Websites List

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www.avios.com

Site 2: Bitcoin

<http://bitcoin.org/>

Site 3: Bitcoin charts

<http://bitcoincharts.com/>

Site 4: Bitcoin Wiki

https://en.bitcoin.it/wiki/Main_Page

Site 5: Dwolla

<https://www.dwolla.com/>

Site 6: Entropia universe

<http://www.entropiauniverse.com/>

Site 7: Financial Services Authority (FSA)

<http://www.fsa.gov.uk/>

Site 8: First Meta Exchange

<http://firstmetaexchange.com/home>

Site 9: Gaming Surplus

<http://www.gamingsurplus.com/#>

Site 10: Google Checkout

<https://checkout.google.com/seller/fees.html>

Site 11: Hub Culture

<http://www.hubculture.com/>

Site 12: Iberia

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<http://www.investinganswers.com/>
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Site 15: PayNearMe
<http://www.paynearme.com/>
Site 16: PayPal
www.paypal.com
Site 17: PayPal Developer Central
https://cms.paypal.com/us/cgi-bin/?cmd=_render-content&content_ID=developer/home
Site 18: PC Magazine (PCMAG)
<http://www.pcmag.com/>
Site 19: Ripplepay
<https://ripplepay.com/>
Site 20: Second Life
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Site 22: The Virtual World Exchange (VirWox)
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Site 23: Ven
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COMPARISON OF THE TAX NEUTRALITY BY MEANS OF THE EFFECTIVE TAX RATES IN THE CZECH REPUBLIC IN THE YEARS 2000 - 2010⁹⁹

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Abstract:

The objective of this paper is to examine **tax neutrality**; that is, to a tax that leaves corporate decisions as to investments or sources of financing unchanged. The tax system that seeks to raise revenue in ways that avoid distortion effects is considered **neutral tax system**. This point is of great importance, for it defines one aim of the current tax system and one criterion by which it may be assessed. The use of **effective tax rates** on different types of capital assets and sources of financing and to assess on the base of calculation of the tax wedges the degree to which taxation affects the incentive to undertake investment in the Czech Republic. The precise methodology used to calculate effective tax rates on marginal investments is based on an approach developed by the King and Fullerton methodology (1984), which has become the most widely accepted method adopted to calculating effective tax rates (**tax wedges**). The tax wedge will vary according to the type of asset: machinery, buildings, inventory (because of different capital allowance rates relative to the assumed true economic depreciation rates) and the type of finance sources: new equity, debt, retained earnings (because the tax treatment of debt, dividends and retained earnings differs). **Effective tax rates** take into account not only the statutory corporate tax rate, but also other aspects of the tax system which determine the amount of tax paid and profitability of investment, a consideration of personal taxes.

Key Words: Effective tax rates, the tax wedges, tax neutrality, type of asset, type of finance sources, taxable profit

Introduction

The profit taxes in use in the developed market economies distort the types of investment which companies undertake, the way they finance those investments and the overall level of investment. All these problems get worse the higher is the level of inflation, because no corporate tax system adjusts fully for the effects of inflation (Heady – Pearson – Rajah. – Smith, 1993. p. 35). Inflation, important as it can be, is only one issue. Other features of a corporation tax system, particularly its effect on corporate decisions as to investments and sources of finance, matter at any inflation rate (King – Wookey, 1987, p. 6).

The tax system that seeks to raise revenue in ways that avoid distortionary substitution effects, as regards decisions on investments or sources of finance, is considered a neutral tax system. This does not imply that the tax system has no impact upon behaviour but instead suggests that there should be an avoidance of high marginal tax rates and that should not be different tax rates on essentially similar activities (Heady – Pearson – Rajah. – Smith, 1993, p. 25).

The appeal is to tax neutrality; that is, to a tax that leaves corporate decisions as to investments or sources of finance unchanged. (King – Wookey, 1987, p. 7).

Taxes impose a real cost to the economy inasmuch as they create distortions in the market allocation of resources. However, not all tax systems are equally distortive, and one obviously attractive objective is to minimize as far as possible the impact of the tax structure on behavior. A corporation tax that achieves this as regards decisions on investments or the sources of finance is described as a neutral tax (King – Wookey, 1987, p. 13).

⁹⁹ This paper has been elaborated as one of the outcomes of the research project of the Faculty of Finance and Accounting in the framework of Institutional support of the University of Economics, Prague under reg. No. IP 100040

Suppose there were no corporation tax, and consider a company appraising an investment project. The company will assess the returns earned on the project after rewarding its suppliers of finance with the required return. To make a profit, the project has to generate at least this return for the company. Now we can measure the effect of introducing a corporation tax in terms of such an investment decision. For it may be that corporation tax raises the pre-tax required return the project needs to earn for the company to be worthwhile, above that needed in the absence of corporation tax. If it does this, the tax drives a 'wedge' between the pre-tax return and post-tax required rate of return, and will have a disincentive effect on corporate investment. In other words, it will not be neutral. For a fully neutral tax, this wedge will be zero (King – Wookey, 1987, p. 7).

The difference between the pre-corporate tax rate of return earned by companies and the post tax receipts an individual gets is a measure of the total distortion (total tax "wedge") caused by taxes. The size of the 'wedge' can be rather good indication of the degree of neutrality in a corporation tax system. The tax wedge provides an extremely useful tool to investigate this aspect of different tax regimes, and is used in the empirical analysis in this paper. Tax wedge is also one form how to calculate effective tax rates.

Effective tax rates are tax rates which take into account not only the statutory corporate tax rate, but also other aspects of the tax system which determine the amount of tax paid and profitability of investment, such as capital allowances and stock relief. Effective tax rates may also require a consideration of personal taxes and the manner (if any) in which the corporate and personal tax systems are integrated (classical, split rate or imputation). Inflation will also alter effective tax rates in various ways, depending on how the tax system calculates taxable profits in the presence of inflation.

Effective tax rates (rather than statutory tax rates) can give us an idea of the level of distortion imposed on investment by the tax system. Therefore, it makes sense to consider the effective taxation of different types of capital assets and sources of financing when evaluating the distortiveness of the tax system. Statutory tax rates measure the tax burden as imposed by the government on specified income (or expenditure) streams. These statutory tax rates do not take into account of depreciation or other deduction, nor do they consider the effects of inflation on the actual amount of tax paid relative to the value of the income stream. Effective tax rates are designed to correct for these facts.

As noted above, there are various factors that are of essential significance using the idea of the tax wedge:

- statutory corporate tax rate
- system and rates of depreciation
- capital structure
- system of personal taxation
- manner of the corporate and personal tax systems integration
- rate of inflation
- capital allowances

There are three rates of return that is useful to focus on when discussing the effects of the tax system on investments decisions:

- real pre-corporate tax rate of return to companies (p),
- real interest rate which is the return that can be earned on a government bond or bank deposit before personal taxes are charged (r – usually 5 %, reflecting a typical real interest rate) and
- real post-personal tax rate of return received by the ultimate financiers of the investment (s).

The relation between the real interest rate (r), and the post-tax real return (s), can be simply stated:

$$s = \frac{1 + i(1 - t_i)}{1 + \pi} - 1$$

where:

π is the rate of inflation,

i is the nominal interest rate, equal to $(1 + r)(1 + \pi) - 1$. and

t_i is the personal tax rate on interest income.

Given the relationships specified between the pre-corporate tax return (p), the interest rate (r), and the post-personal tax return (s), various effective tax rates or wedges can be calculated (on capital assets – as machinery, buildings, inventories or sources of finance – as new equity, retained earnings,

debt). The difference between p (the pre-tax rate of return to companies) and s (the post-tax rate of return to individuals) reflects the overall size of the distortion in the market caused by corporate and personal taxes.

There are three relevant measures of the effective tax rates on business:

1. first is the (p) required to get a particular value of (r) ,
2. secondly is the tax wedge – the percentage difference between (p) and (s) ,
3. thirdly is the tax rate – the tax wedge $(p - s)$ divided (p) . The tax rate is not always a useful figure, because the tax wedge may be similar in two different cases, but (p) may vary, giving substantial differences in the tax rate.

The basic aim of the King and Fullerton approach is to derive the difference between the real rate of return required from an investment project pre-tax and post-tax. In the absence of tax these will, of course, be equal to each other and also equal, by assumption, to the prevailing real interest rate (r) . However, corporation taxes may cause the pre-tax required real rate of return, also termed the cost of capital, (p) , to diverge from the interest rate. In addition, personal taxes may reduce the post-tax real return to the individual investor (s) below the interest rate.

The methodology and calculations of tax wedges include the corporate tax rate, depreciation allowances, the valuation of dividends, personal tax rates on dividend income, interest income and capital gains, rate of inflation.

Three forms of financing the company are considered:

- Retained earnings (RE)
- New equity (NE)
- Debt (borrowings) (D)

Investment in three assets that are distinguished in the balance sheet:

- Machinery (M)
- Buildings (B)
- Inventories (I)

The precise methodology used to calculate effective tax rates on investments in this paper is closely based on an approach developed by King and Fullerton (1984) that enables complicated provisions of tax codes to be modeled in a rigorous manner.

Analysis of the tax neutrality (using tax wedges) in the Czech Republic

As noted above, there are various factors that are of essential significance using the idea of the tax wedge.

Assumptions and parameters used in the calculation:

Sector	Manufacturing
Sources of finance	Retained earnings (RE), new equity (NE), debt (D)
Types of asset	Machinery (M), buildings (B), inventories (I)
The weights used for finance	55 % RE, 10 % NE, 35 % D
The weights for assets	50 % M, 28 % B, 22 % I
Length of life for tax purposes	Machinery 6 years (tax rate 16.66 %), buildings 30 years (tax rate 3.33 %)
Economic depreciation rate	Machinery 12.3 %, buildings 3.6 %
Inventories are assumed not to be depreciated	
The real interest rate	5 %
The inflation rate	5 % in the year 2000, 1,5 % in year 2010
Personal tax rates of individual investors	rate on interest ($t_i = 15$ %), rate on dividends ($t_d = 25$ %), rate on capital gains ($z = 32$ %).
Statutory corporate tax rate t	31 % in year 2000, 15 % in year 2010

There is a number of steps in calculating tax wedges. They are as follows:

1. find the nominal rate of interest [i] given by the formula

$$i = (1 + r) \cdot (1 + \pi) - 1 \quad (1)$$

$$i = (1 + 0,05) \cdot (1 + 0,05) - 1 = (1,05 \cdot 1,05) - 1 = \mathbf{0,1025}$$

- i = nominal interest rate,
- r = real interest rate (5 %, i.e. 0.05),
- π = inflation rate.

2. find the discount rate for each type of finance [p']

(a) retained earnings:

$$p'_{RE} = \frac{(1 - t_i) \cdot i - z \cdot \pi}{1 - z} \quad (2)$$

- t_i = tax rate on interest,
- t_d = tax rate on dividends,
- z = tax rate on capital gains.

The capital gains tax rate Z , is the accrual equivalent rate applied to the nominal capital gain. To calculate this rate, it is necessary to make some assumption regarding the time at which the shareholder sells his shares, realizes the gain and hence faces a tax liability. The approach of King (1997) is followed in assuming that the shareholder sells a constant proportion α , of his stock of assets in each period is normally taken to be 10 %. In this case, the accrual equivalent capital gain tax rate. is simply the present value of taxes due on a capital gain of one period t , that is:

$$Z = \frac{\alpha \cdot z_r \cdot (1 + j)}{\alpha + j} \quad (3)$$

- J = $i \cdot (1 - t_i)$, tj. shareholders discount rate ,
- z_r = statutory tax rate on capital gains after sale,
- α = proportion of stock of assets realized in each year

$$Z = \frac{0,032 \cdot (1 + 0,1025 \cdot 0,85)}{0,1 + (0,1025 \cdot 0,85)} = \frac{0,04527}{0,187125} = 0,185908$$

$$p'_{RE} = \frac{(1 - 0,15) \cdot 0,1025 - 0,185908 \cdot 0,05}{1 - 0,185908} = 0,09560$$

(b) new equity:

$$p'_{NE} = \frac{(1 - t_i) \cdot i - z \cdot \pi}{1 - t_d} \quad (4)$$

$$p'_{NE} = \frac{(1 + 0,15) \cdot 0,1025 - 0,185908 \cdot 0,05}{1 - 0,25} = 0,10377$$

(c) debt:

$$p'_D = (1 - t) \cdot i \quad (5)$$

- T = corporate tax rate.

$$p'_D = (1 - 0,31) \cdot 0,1025 = 0,07073$$

3. find the present value of depreciation allowances [A].

The formula for the calculation of the present value of depreciation allowances can be used for declining balance and straight line (linear) depreciation schedules.

For straight line schedule is as follows:

$$A_s = \frac{o \cdot t \cdot (1 + p')}{p'} \cdot \left[1 - \frac{1}{(1 + p')^N} \right] \quad (6)$$

N = number of years for ($N = I / o$),

o = tax depreciation rate,

o_m = 0.166666 for machinery (in ČR),

o_b = 0.033333 for buildings (in ČR),

p' = discount rate for each type of finance

t = corporate tax rate

For declining balance schedule is as follows:

$$A_D = \frac{o \cdot t \cdot (1 + p')}{p' + o} \quad (7)$$

In this calculation the straight (linear) schedule (prevailing in the Czech Republic) will be considered according the formula (6).

This must be calculated for each of machinery and buildings (inventories do not receive any allowance). In each case, the present value depends on the company's discount rate, which, as we have seen in step 2. in turn depends on the source of finance.

Present value of depreciation for **machinery**:

There are three possible values of the discount rate p' corresponding to the values given above. We take each in turn:

$$A_{M, RE} = \frac{0,16666 \cdot 0,31 \cdot (1 + 0,095603)}{0,095603} \cdot \left(1 - \frac{1}{1,095603^6} \right) = 0,592071 \cdot 0,42179 = 0,24974$$

$$A_{M, NE} = \frac{0,1666 \cdot 0,31 \cdot (1 + 0,103773)}{0,103773} \cdot \left(1 - \frac{1}{1,103773^6} \right) = 0,54954 \cdot 0,44701 = 0,24565$$

$$A_{M, D} = \frac{0,1666 \cdot 0,31 \cdot (1 + 0,070725)}{0,070725} \cdot \left(1 - \frac{1}{1,070725^6} \right) = 0,78219 \cdot 0,33636 = 0,26310$$

Present value of depreciation for **buildings**:

The buildings are depreciated over 30 years. Using (6) we again need to take each of the sources of finance in turn:

$$A_{B, RE} = \frac{0,3333 \cdot 0,31 \cdot (1 + 0,095603)}{0,095603} \cdot \left(1 - \frac{1}{1,095603^{30}} \right) = \frac{0,0113212}{0,095603} \cdot 0,935375 = 0,11077$$

$$A_{B, NE} = \frac{0,3333 \cdot 0,31 \cdot (1 + 0,103773)}{0,103773} \cdot \left(1 - \frac{1}{1,103773^{30}} \right) = \frac{0,011405}{0,103773} \cdot 0,948287 = 0,10423$$

$$A_{B, D} = \frac{0,3333 \cdot 0,31 \cdot (1 + 0,070725)}{0,070725} \cdot \left(1 - \frac{1}{1,070725^{30}} \right) = \frac{0,0110640}{0,070725} \cdot 0,871276 = 0,13630$$

Thus, in each case the present value of depreciation allowances rises as the discount rate falls, since future allowances are not discounted so heavily.

Present value of depreciation allowances depends except from the rate of depreciation on:

- 1) Discount rate of the company for a particular type of finance.
- 2) Source of finance

Because inventories are not depreciated the present value is not calculated.

4. find the real required pre-tax rate of return (p)

There are nine different rates of return to be calculated, corresponding to an investment in the three assets each funded from each of the three sources of finance. Again they are taken into turn.

This requires four additional parameters not already used: the economic depreciation rate d for machinery, for buildings and for inventories, which are assumed to be 12.25 % (i.e. 0.1225) and 3.61 % (i.e. 0.0361) and zero, respectively, and the proportion of inventories which are valued using the FIFO method, v , which in the Czech Republic is nearly 100 % (i.e. 1.0). LIFO is not allowed.

The calculation for machinery and buildings uses this formula:

$$p = \frac{1 - A}{(1 - t) \cdot (1 + \pi)} \cdot [p' - \pi + d \cdot (1 + \pi)] - d \quad (9)$$

$d_m = 0.1225$ for machinery,

$d_b = 0.0361$ for buildings.

The formula for inventories is as follows:

$$p = \frac{1 - A}{(1 - t) \cdot (1 + \pi)} \cdot [p' - \pi + d \cdot (1 + \pi)] + \frac{v \cdot t \cdot \pi}{(1 - t) \cdot (1 + \pi)} - d \quad (10)$$

The expression (10) shows the calculation for the cost of capital when the inflationary increase in the value of inventories is taxed. With $v=1$, the calculations are therefore as follows: If inflation rate is high then it implies the increase of tax wedge for inventories.

Now we can calculate the real required pre-tax rate of return (p) that also represent cost of capital.

Machinery (according to formula 9):

Retained earnings:

$$p_{M, RE} = \frac{1 - 0,2497430}{(1 - 0,31) \cdot (1 + 0,05)} \cdot [0,095603 - 0,05 + 0,1225 \cdot (1 + 0,05)] - 0,1225 = 0,0579 = 5,79\%$$

New equity:

$$p_{M, NE} = \frac{1 - 0,24565}{(1 - 0,31) \cdot (1 + 0,05)} \cdot [0,103773 - 0,05 + 0,1225 \cdot (1 + 0,05)] - 0,1225 = 0,0674 = 6,74\%$$

Debt:

$$p_{M, D} = \frac{1 - 0,263097}{(1 - 0,31) \cdot (1 + 0,05)} \cdot [0,070725 - 0,05 + 0,1225 \cdot (1 + 0,05)] - 0,1225 = 0,0294 = 2,94\%$$

Buildings (according to formula 9):

Retained earnings:

$$p_{B, RE} = \frac{1 - 0,110766}{(1 - 0,31) \cdot (1 + 0,05)} \cdot [0,095603 - 0,05 + 0,0361 \cdot (1 + 0,05)] - 0,0361 = 0,0664 = 6,64\%$$

New equity:

$$p_{B, NE} = \frac{1 - 0,10423}{(1 - 0,31) \cdot (1 + 0,05)} \cdot [0,103773 - 0,05 + 0,0361 \cdot (1 + 0,05)] - 0,0361 = 0,0774 = 7,74\%$$

Debt:

$$p_{B, D} = \frac{1 - 0,13630}{(1 - 0,31) \cdot (1 + 0,05)} \cdot [0,070725 - 0,05 + 0,0361 \cdot (1 + 0,05)] - 0,0361 = 0,0338 = 3,38\%$$

Inventories (according to formula 10):

Retained earnings:

$$p_{I, RE} = \frac{1-0}{(1-0,31) \cdot (1+0,05)} \cdot [0,095603 - 0,05 + 0 \cdot (1+0,05)] + \frac{1 \cdot 0,31 \cdot 0,05}{(1-0,31) \cdot (1+0,05)} - 0 = 0,0843 = 8,43\%$$

New equity:

$$p_{I, NE} = \frac{1-0}{(1-0,31) \cdot (1+0,05)} \cdot [0,103773 - 0,05 + 0 \cdot (1+0,05)] + \frac{1 \cdot 0,31 \cdot 0,05}{(1-0,31) \cdot (1+0,05)} - 0 = 0,0956 = 9,56\%$$

Debt:

$$p_{I, D} = \frac{1-0}{(1-0,31) \cdot (1+0,05)} \cdot [0,070725 - 0,05 + 0 \cdot (1+0,05)] + \frac{1 \cdot 0,31 \cdot 0,05}{(1-0,31) \cdot (1+0,05)} - 0 = 0,050 = 5\%$$

5. find the post-tax return to investors [s]

$$s = \frac{1 + i \cdot (1 - t_i)}{1 + \pi} - 1 \tag{11}$$

$$s = \frac{1 + 0,1025 \cdot (1 - 0,15)}{1 + 0,05} - 1 = 3,54\%$$

6. find the average real required pre-tax rates of return [p]:

Step 4. yielded nine different costs of capital. These are combined into the weighted averages in the table below. Weights for assets type of 50 % for machinery, 28 % for buildings and 22 % for inventories, and weights for source of finance of 55 % for retained earnings, 10 % for new equity and 35 % for debt. These weights yield in the following table:

Table 1: Weights yield

<i>P</i>	RE	NE	D	weighted average
Buildings [B]	6,64%	7,73%	3,38%	5,61%
Machinery [M]	5,79%	6,74%	2,94%	4,89%
Inventories [I]	8,43%	9,56%	5,00%	7,34%
1.1.1.2.1.1. Weighted average	6,61%	7,64%	3,52%	

7. find the weighted average tax wedge [p - s], s = 3,54

Table 2: Weighted average tax wedge year 2000

<i>p - s</i>	RE	NE	D	weighted average
Buildings [B]	3,10%	4,19%	-0,16%	2,07%
Machinery [M]	2,26%	3,21%	-0,60%	1,35%
Inventories [I]	4,90%	6,03%	1,46%	3,81%
Weighted average	3,07%	4,10%	-0,02%	2,09%

Note: Model with calculations in Annex 1.

Table 3: Weighted average tax wedge_year 2010

<i>p – s</i>	RE	NE	D	weighted average
Buildings [<i>B</i>]	1,19%	1,59%	0,67%	1,05%
Machinery [<i>M</i>]	0,85%	1,21%	0,35%	0,71%
Inventories [<i>I</i>]	1,51%	1,91%	0,97%	1,36%
Weighted average	1,09%	1,47%	0,58%	0,95%

Note: Model with calculations in Annex 2.

Conclusion

Calculation has been done for years 2000 and 2010. If making a comparison of tax wedges values in the year 2010 with values calculated for the year 2000 that are indicated in the tables above, we can interpret the results.

The values of the tax wedges for 2010 can be interpreted as follows: e.g. Line 2 shows, that company which needs to guarantee investments into machinery financed from the combination of retained earnings, of new share and borrowings (debt), must ensure the rate of return of 0,71 percentage points higher than the investor really receives after taxation, in 2000 it was 1,35 (twice more than in 2010) – positive change. The difference will be paid to the government in the form of the taxes. Tax wedge within buildings and other constructions is higher (by 1,05 percentage points, by 2,07 in 2000, also twice more than in 2010) and investments into stocks are being taxed at the highest rate (by 1,36 percentage points, by 3,81 in 2010), the decrease is also positive change.

If we look at the sources of financing, we can see that combined investment into machinery, buildings and stocks is taxed both in case of financing from retained earnings and new equity. The difference between these two methods is negligible. In both these cases, company has to ensure rate of return which is 1,09%, resp. 1,47%, resp. 0,58 % higher than the final post-tax rate that the investor actually gets. The analysis in this paper suggests that Czech tax system tends to favor investment in machinery in relation to buildings and, particularly, in relation to inventories. Tax system is also not neutral as between alternative sources of corporate finance. The data indicate that debt finance tends to be favored over equity and retained earnings.

On average, total rate of return (total tax wedge) of the company before taxation is 0,95 percentage points higher than rate of return after tax actually received by the investor. This total tax wedge is much lower than the OECD average, which is 2.4 resp. 2.1. as shown in the table below. Even partial tax wedges are similar the values in OECD countries. There are even lower in some cases. Shortening the depreciation period has got a major influence on lowering the tax wedge within the category of machinery and buildings.

If comparing the values from 2010 and 2000 we can see improvements in the calculated values (decrease both in the values of partial tax wedges and the total average from 2,09 to 0,95 percent). This positive change has been mainly caused by the interaction of following factors (in the table), decreased corporate tax rate, inflation rate, tax rate on capital gains and dividends, as well, in particular bring the tax system nearer tax neutrality.

Factor	Year 2000	Year 2010
Inflation	5 %	1,5 %
Tax rate on capital gains	32 %	15%
Tax rate on dividends	25 %	15 %
Corporate tax rate	31 %	19 %
Number of year for machinery depreciations	6 years	6 years
Number of years for building depreciations	45 years	30 years

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Annex 1

TAX WEDGES 2000

Assumptions and variables of the model

Real interest rate	r	5%
Inflation rate	π	5%
Tax rate on interest	ti	15%
Tax rate on dividends	td	25%
Tax rate on capital gains	zr	32%

Corporate tax rate	t	31%
Alfa	□	10%
<hr/>		
Tax depreciation rate on buildings	ob	3%
Tax depreciation rate on machinery	om	16.7%
Proportion of inventories valued by FIFO	v	100.0%
<hr/>		
Economic depreciation rate on buildings	db	3.61%
Economic depreciation rate on machinery	dm	12.25%
<hr/>		
Weight for retained earnings	RE	55%
Weight for new equity	NE	10%
Weight for debt	D	35%
<hr/>		
Weight for buildings	B	28%
Weight for machinery	M	50%
Weight for inventories	I	22%
<hr/>		
Nominal interest rate	i	10%
Shareholders' discount rate	j	9%
Length of depreciation of buildings (years)	Nb	30
Length of depreciation of machinery (years)	Nm	6
<hr/>		
Required post – tax return to investors	s	3.54%
<hr/>		

Discount rates

<i>P'</i>	RE	NE	D
p' (B, M, I)	0,095603	0,103773	0,070725

Present value of depreciation allowances

<i>A</i>	RE	NE	D
Buildings (B)	0,110766	0,104226	0,136302
Machinery(M)	0,249744	0,245651	0,2631

Required pre – tax rate of returns

<i>P</i>	RE	NE	D	<i>Weighted average.</i>
Buildings (B)	6,64%	7,73%	3,38%	5,61%
Machinery(M)	5,79%	6,74%	2,94%	4,89%
Inventories (I)	8,43%	9,56%	5,00%	7,34%
<i>Weighted</i>	6,61%	7,64%	3,52%	

Tax wedges	<i>average</i>				
	<i>Wedge</i> <i>(p - s)</i>	RE	NE	D	<i>Weighted average</i>
Buildings (B)		3,10%	4,19%	-0,16%	2,07%
Machinery(M)		2,26%	3,21%	-0,60%	1,35%
Inventories (I)		4,90%	6,03%	1,46%	3,81%
<i>Weighted average</i>		3,07%	4,10%	-0,02%	2,09%

Annex 2

TAX WEDGES 2010

Assumptions and variables of the model

Real interest rate	r	5%
Inflation rate	<input type="checkbox"/>	1,5%
Tax rate on interest	ti	15%
Tax rate on dividends	td	15%
Tax rate on capital gains	zr	15%
Corporate tax rate	t	19%
Alfa	<input type="checkbox"/>	10%
Tax depreciation rate on buildings	ob	3%
Tax depreciation rate on machinery	om	16.7%
Proportion of inventories valued by FIFO	v	100.0%
Economic depreciation rate on buildings	db	3.61%
Economic depreciation rate on machinery	dm	12.25%
Weight for retained earnings	RE	55%
Weight for new equity	NE	10%
Weight for debt	D	35%

Weight for buildings	B	28%
Weight for machinery	M	50%
Weight for inventories	I	22%
Nominal interest rate	i	7%
Shareholders' discount rate	j	6%
Length of depreciation of buildings (years)	Nb	30
Length of depreciation of machinery (years)	Nm	6
Required post – tax return to investors	s	4,03%

Discount rates

<i>P'</i>	RE	NE	D
p' (B, M, I)	0,060512	0,063957	0,055888

Present value of depreciation allowances

<i>A</i>	RE	NE	D
Buildings (B)	0,072591	0,070227	0,075984
Machinery(M)	0,130163	0,129185	0,131498

Required pre – tax rate of returns

<i>P</i>	RE	NE	D	<i>Weighted average.</i>
Buildings (B)	5,22%	5,61%	4,69%	5,08%
Machinery(M)	4,87%	5,24%	4,38%	4,74%
Inventories (I)	5,54%	5,94%	5,00%	5,39%
<i>Weighted average</i>	5,12%	5,50%	4,61%	

Tax wedges

<i>Wedge (p – s)</i>	RE	NE	D	<i>Weighted average</i>
Buildings (B)	1,19%	1,59%	0,67%	1,05%
Machinery(M)	0,85%	1,21%	0,35%	0,71%
Inventories (I)	1,51%	1,91%	0,97%	1,36%
<i>Weighted average</i>	1,09%	1,47%	0,58%	0,95%

GLOBAL FINANCIAL CRISIS AND RESTRUCTURING OF GLOBAL ECONOMY – EVIDENCE FROM GLOBAL FDI INFLOWS, OUTFLOWS AND NETFLOWS

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Abstract:

The present paper is an attempt to analyze the impact of recent global slow down on the restructuring of the global economy. It tries to provide empirical basis for the same through examining important international macroeconomic variables like FDI Inflows, FDI Outflows, FDI Net flows etc. Regression, Correlation and Granger Causality tests have been employed for recognizing trends and relationships. The results indicate that the developing region of the world is improving their economic status in international arena in terms of GDP growth rates, FDI inflows and outflows.

Key Words: Global crisis, global FDI inflows, outflows and netflows

The present Global Financial Crisis (GFC) started to appear in mid-2007. When the US economy witnessed a decline in real GDP for more than four months everyone suspected an ensuing slowdown. Officially the bubble got burst with the failure of Lehman Brothers, the leading financial institution in United States of America. Though economic fluctuations follow different trends, the present recession is regarded as a black swan because of it being a low probability event, an outlier, outside realm of reasonable expectations and carrying an extreme impact. We already know since the experience of Great Depression of 1930s how drastic the effects of such a crisis can be. One of the major impacts of the recent slowdown has been the restructuring of the global economy in different aspects.

Objectives set for the present paper are:

1. To highlight the causes and consequences of the present GFC with a special focus on restructuring of global economy.
2. To focus and empirically analyse gradual shifts in global economy in terms of FDI Inflows and Outflows.

Methodology

The paper has employed both descriptive and analytical approach. Towards first objective it overviews existing literature and summarizes the main findings, focusing particularly on some topics which deemed important. For empirical analysis Regression, Correlation and Granger Causality tests have been employed identifying significant trends and relationships.

Coming to the causes of the present GFC, the most important one has been the collapse of US Sub-Prime mortgage market because of reversal of the housing boom. Shorters¹ were the ones blamed for forcing down the market value of Banking Group HBOS. The underlying factor for both of these has been weak regulation of financial sector. Joseph Stiglitz points that American financial system failed in its two crucial responsibilities of managing risk and allocating capital. In other words financial crisis emerged from an over-supply of financial innovation and an under-supply of financial regulation within the core advanced economies². Other causes have been soaring commodity prices, increasingly restrictive monetary policies in a number of countries, and stock market volatility³.

Today's world being more of a global village with greater integration, the effects of crisis in one big country gets rippled and most of the countries are affected in one way or other. The most important consequences have been

- **Collapse of world's largest financial institutions resulting in the fall of stock markets**
- **The credit crisis and high cost of borrowing led to many a job cuts across different countries and sectors.**

- **Fall in consumption levels which in Keynesian terms is dearth of aggregate effective demand affected the whole economy.**

If these were the immediate effects in the developed countries the developing countries are facing a different set of problems altogether.

- **Soaring food prices, fuel prices and prices of other commodities. This drastically affects those developing countries which depend on goods for their import and export.**
- **Because of Uncertainty and instability in international financial currency and commodity markets coupled with doubts about the monetary policy to be pursued by developed nations, many developing nations became uncertain about the policy they themselves have to pursue.**
- **With fewer funds available for development, the GFC has become a crisis of poverty for humanity. The social protection commitments have received a setback⁴.**
- **There has been evidence of negative or slow growth rates and negative effects on important sectors like agriculture, manufacturing⁵, energy⁶, insurance⁷ etc.**

The magnitude of the effects of GFC or recession calls for the coping strategies both at macro and micro levels. At macro level it is global and national strategies and at micro it is strategies followed by individual enterprises. One of the themes of this seminar being managing recession in global context I limit to macro strategies. The immediate strategy thought out in countries drastically affected by GFC was bail-out and rescue packages*. The Keynesian thought which had been left out in way back 1970s again entered the minds of policy makers as a remedy to the present GFC. Apart from bail-outs other remedial measures considered by nations were

- **To stop market manipulations like shorting.**
- **Nationalization of Banks in some European countries.**
- **The most important one has been to stimulate economy through reduced interest rates, reduce taxes, support borrowing activities, increased spending on public works etc which is based on Keynesian ideas.**

The strategies thought of at global level include:

- **Restructuring and strict supervision of International Financial System including reforming of Bretton Woods Institutions (BWIs). “One size fits all” attitude of these institutions should be done away with.**

As John Vandaele Journalist puts it - The most powerful international institutions tend to have the worst democratic credentials: the power distribution among countries is more unequal, and the transparency, and hence democratic control, is worse.

- **Increasing capital and liquidity requirements at financial institutions.**
- **The introduction of a country bankruptcy code that will enable orderly sovereign debt restructuring.**
- **Not just expanding the capital adequacy requirement, but also making it counter-cyclical, rather than pro-cyclical as it currently is (i.e. making credit a bit harder to get during good times).**
- **Stricter regulations of tax havens and private equity funds, which have greatly contributed to increasing opacity in the financial market.**
- **Credit rating agencies play a critical role in today’s financial system and given the damages they have inflicted by blessing all those toxic assets, these agencies need to be much more heavily regulated or even replaced by an international public body⁸.**
- **Crackdown on international tax havens to address harmful tax competition between states⁹. So that some tax revenue is generated within states.**
- **Better representation of developing countries at international financial institutions. Like G20 instead of G8*. (But 3% of votes will not do).**

In fact Joseph Stiglitz talks about BW II which works both in emerging and capitalist economies. China has been voicing concerns over having alternative to US dollar at international level. All this indicates that the present crisis might have provided an opportunity for power shift which of course will be opposed by the powerful ones. Harvard professor of economics, Stephen Marglin says that GFC has provided an opportunity of Rethinking Economics away from the neo-

liberal economic ideas. The gaining importance of the developing world in global arena can be clearly observed in terms of FDI inflows, FDI outflows and recent GDP growth rates.

After 1980, the restrictions on FDI (Foreign Direct Investment) over the world were dramatically reduced. This was due to host of factors like globalization policies of developing countries, accelerating technological change, emergence of globally integrated production and marketing networks, existence of bilateral investment treaties, prescriptions from multilateral development banks, and positive evidence from developing countries that have opened their doors to FDI. In addition, the drying-up of commercial bank lending due to debt crises brought many developing countries to reform their investment policies to attract foreign capital; in this case FDI appeared to be an attractive alternative to bank loans as a source of capital inflows. In the process, incentives and subsidies were aggressively offered, particularly to multinational companies (MNCs) that supported developing countries industrial policies. This led to a rapid expansion of FDI flows around the world during the last 30 years. From only \$51.5 billion in 1980, FDI outflows reached \$1.2 trillion in 2000 and \$1.9 trillion in 2007 (UNCTAD 2008).

For the sake of empirical analysis the data on world FDI inflows was classified into Developed and developing at first instance and continent wise classification has also been considered. Two Granger causality test were run for both the classifications.

The data covers world and region wise FDI inflows for the period 1980-2007. Data are secondary which have been collected form IMF and UNCTAD. The econometric technique employed for empirical analysis include OLS regressions, ADF test and Granger causality test which are explained in detail in the later stage of the article.

The linear regression models specified for the study are:

$$\text{World FDI}_i = \alpha_i + \beta_1 \text{Developed FDI}_i + \beta_2 \text{Developing FDI}_i + \varepsilon_i \quad (1)$$

$$\text{World FDI}_i = \alpha_i + \beta_1 \text{Africa FDI}_i + \beta_2 \text{Asia FDI}_i + \beta_3 \text{America FDI}_i + \beta_4 \text{Oceania FDI}_i + \beta_5 \text{Europe FDI}_i + \varepsilon_i \quad (2)$$

While ε_i represent the “noise” or error term; α_i and $\beta_{i,s}$ represent the slope and coefficients of regression.

Table1. Regression results of model 1

Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	917.2115	831.0984	1.103614	0.2812
Developed	0.989280	0.003109	318.1702	0.0000
Developing	1.117395	0.051031	21.89620	0.0000
R ²	0.999527			
Adjusted R ²	0.999486			
Durbin-Watson	1.947032			

Table1. clearly specifies that the regression coefficients of model 1 are statistically significant indicating that both developed and developing FDI inflows influences the world FDI inflows.

Both the variables influence the world FDI inflows in almost same proportion. The regression equation for model 1 is specified as:

$$\text{World} = 917.21 + 0.98(\text{Developed}) + 1.11(\text{Developing})$$

Table 2. Regression results of model 2

Variables	Coefficient	Std. Error	t-Statistic	Prob.
C	193.9316	2089.640	0.092806	0.9270
AFRICA	1.546016	0.545122	2.836093	0.0102
AMERICA	1.097268	0.051086	21.47884	0.0000
ASIA	0.498881	0.146472	3.405977	0.0028
OCEANIA	0.845013	0.109970	7.684035	0.0000
EUROPE	1.026456	0.021023	48.82581	0.0000
R ²	0.998236			
Adjusted R ²	0.997796			
Durbin-Watson	2.183856			

The regression coefficients of second model are also statistically significant. That is all the variables have the capacity to explain variations in world FDI inflows. However, influence of Africa, America and Europe is greater when compared to Asia and Oceania. The regression equation for model 2 is specified as:

$$\text{World} = 193.93 + 1.54(\text{Africa}) + 1.09(\text{America}) + 0.49(\text{Asia}) + 0.84(\text{Oceania}) + 1.02(\text{Europe})$$

The Ordinary Least squares regression analysis establishes the dependence of one variable on others; this does not necessarily imply direction of causation between the variables. Kendall and Stuart (1961) noted that “a statistical relationship, however strong and however suggestive, can never establish causal connection”. Therefore, this study employs another popular method, the Granger causality test, used to study the direction of causality between the variables considered.

Results

Table 3. Granger causality results for world, developed and developing FDI inflows

Null Hypothesis:	Obs	F-Statistic	Probability
DEVELOPED2 does not Granger Cause WORLD2	24	0.00489	0.99512
WORLD2 does not Granger Cause DEVELOPED2		0.04861	0.95267
DEVELOPING2 does not Granger Cause WORLD2	24	0.00737	0.99266
WORLD2 does not Granger Cause DEVELOPING2		3.13628	0.06653
DEVELOPING2 does not Granger Cause DEVELOPED2	24	0.04132	0.95961
DEVELOPED2 does not Granger Cause DEVELOPING2		3.12313	0.06719

Table 3. Granger causality results for world and other regions

OCEANIA2 does not Granger Cause WORLD2	24	1.37323	0.27731
WORLD2 does not Granger Cause OCEANIA2		1.15779	0.33538
AMERICA2 does not Granger Cause WORLD2	24	0.83537	0.44903
WORLD2 does not Granger Cause AMERICA2		1.03967	0.37283

ASIA2 does not Granger Cause WORLD2	24	4.51468	0.02488
WORLD2 does not Granger Cause ASIA2		10.9264	0.00069
EUROPE2 does not Granger Cause WORLD2	24	0.06894	0.93361
WORLD2 does not Granger Cause EUROPE2		2.86205	0.08194
AFRICA2 does not Granger Cause WORLD2	24	4.54146	0.02443
WORLD2 does not Granger Cause AFRICA2		2.65434	0.09626
AMERICA2 does not Granger Cause OCEANIA2	24	0.87948	0.43123
OCEANIA2 does not Granger Cause AMERICA2		7.22387	0.00464
ASIA2 does not Granger Cause OCEANIA2	24	1.95640	0.16882
OCEANIA2 does not Granger Cause ASIA2		1.52468	0.24316
EUROPE2 does not Granger Cause OCEANIA2	24	2.41369	0.10600
OCEANIA2 does not Granger Cause EUROPE2		0.98660	0.39115
AFRICA2 does not Granger Cause OCEANIA2	24	6.04980	0.00927
OCEANIA2 does not Granger Cause AFRICA2		3.58049	0.04791
<i>ASIA2 does not Granger Cause AMERICA2</i>	<i>24</i>	<i>24.0817</i>	<i>0.00233</i>
AMERICA2 does not Granger Cause ASIA2		6.55462	0.00684
EUROPE2 does not Granger Cause AMERICA2	24	1.56980	0.23391
AMERICA2 does not Granger Cause EUROPE2		5.02507	0.01771
AFRICA2 does not Granger Cause AMERICA2	24	3.06021	0.07045
AMERICA2 does not Granger Cause AFRICA2		8.89318	0.00188
EUROPE2 does not Granger Cause ASIA2	24	10.6681	0.00078
ASIA2 does not Granger Cause EUROPE2		1.20011	0.32299
AFRICA2 does not Granger Cause ASIA2	24	7.16589	0.00480
ASIA2 does not Granger Cause AFRICA2		9.51289	0.00137
AFRICA2 does not Granger Cause EUROPE2	24	0.96675	0.39826
EUROPE2 does not Granger Cause AFRICA2		3.33789	0.05724

Chart 1 Granger causality relations in the first model

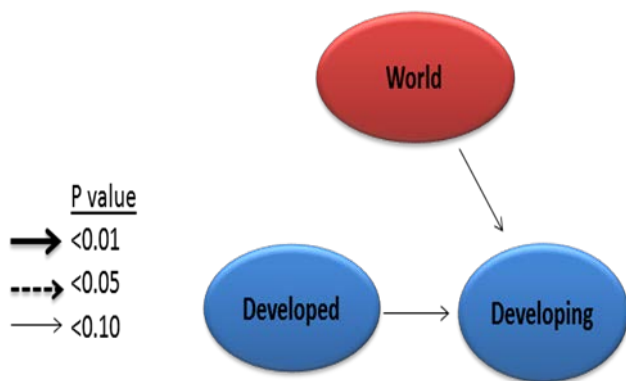
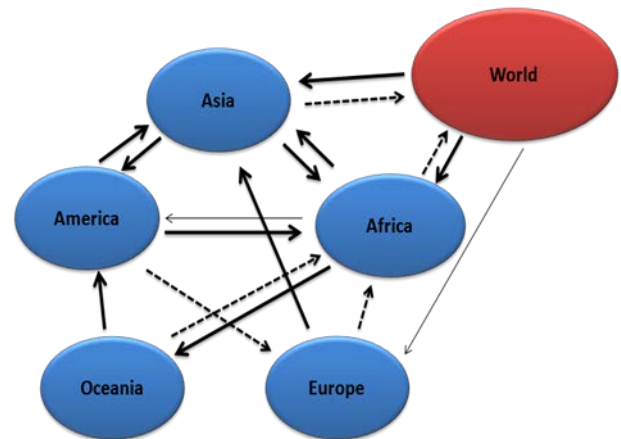


Chart 2 Granger causality relations in the second model



Causal relationship of world with other regions:

It is quite obvious from the chart 1 that both world as well as developed countries FDI inflows is causing developing countries FDI inflows; however developing countries are causing neither world nor developed FDI inflow. On the other side there is no relationship between world and developed FDI inflows.

Chart 2 indicates that world has bidirectional causal relationship with Asia and Africa, whereas it has unidirectional causal relationship with Europe with world causing Europe inflows. Same has been observed in the Granger Causality tests among world, developed and developing regions.

Africa is one of the regions which is sharing bicausal relationships with world as well as three regions namely Asia, America and Oceania. Whereas Europe FDI inflows causes African FDI inflows and not vice versa, indicating unidirectional causal relationship.

In case of Asia the Granger causality test results indicate Asia sharing bicausal relationship with world, Africa and America. Like African case Asia has unidirectional relation with Europe.

America causes Asia, Africa and Europe. Whereas, America is caused by Oceania, Asia and Africa. Thus is clear that America has bidirectional causal relationship with Asia, Africa and unidirectional with Oceania and Europe.

The striking aspect observed in the case of Europe is the fact that it shares unidirectional relationship and no bicausal relations. Europe causes Asia, Africa and gets caused by America and world.

Oceania has relationship with only Africa and America. With Africa it has two way relationships whereas with America it is one way with Oceania causing America.

Conclusion

The OLS regression results indicate the significance of developed and developing and also of all the regions in explaining world FDI inflows. The Granger causality test results for the different regions of the world clearly complement the Granger causality test results for world, developed and developing. Where both developed regions and world causes developing region FDI inflows but developing does not causes neither world nor developed.

The most important observation is Asia and Africa indicating similar kind of Granger causality test results. Both Africa and Asia share bicausal relationships among themselves and with world and America. Europe causes both Asia and Africa this can be because of the application of the theories of location as a region, cost-reduction pressures, liberalized investment environment, institutional prerequisites for attracting FDI and cultural proximity for these two regions. The only difference is the absence of causal relationship between Oceania and Asia and presence of bicausal relationship with Oceania and Africa. The similarity of results for African and Asian regions can be attributed to the fact that both are potential market for FDI inflows with presence of vast area and population.

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Shorter is a trader borrows shares from a big City investor who charges a fee for the service. The trader then sells the shares in the hope of buying them back more cheaply when the price falls and returning them to their rightful owner. The difference between the two prices is the profit.

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The G20 represents the G8, the EU as a bloc and 12 emerging economies: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States of America.

As well as the EU being represented as a bloc, IMF and World Bank representatives are usually present at G20 meetings. Although it is an informal structure, it comprises 90% of the world's economic output and some 80% of the world's population, although the poorest 20% (over 160 nations) are not represented by this group.

THE LONG - TERM UNEMPLOYMENT AND POVERTY AS AN INTERDISCIPLINARY PROBLEM

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Abstract:

The author in her article focuses on the issue of long-term unemployment and poverty, which often results in interdisciplinary problems. It is a problem of the whole society, which needs to be constantly looked into and it also constantly needs the elimination of the outside world's effects on it. The aim of this work is to highlight the seriousness of this problem, the need for its elimination, with emphasis on the confrontation between scientific disciplines and their connections.

Key Words: Unemployment, work, personality, poverty, risks, social and psychological consequences

Unemployment is one of the most discussed macroeconomic indicators of the market economy and is a global problem that continues to affect an individual's life and it also affects the whole society. In Slovakia, the unemployment is still an enduring problem triggered by many causes with detrimental effects. Unemployment is a shocking life event that creates a disruption in a person's life. Since it is affecting the life of all unemployed, the unemployment is more than just the exclusion from the production process. The economical problems are at the same time the most important. The social insurance network during the unemployment reduces serious financial problems, but the unemployment usually brings the lost of social contacts, slid into social isolation, a growing sense of powerlessness and therefore it presents a substantial disturbance in personal self-development of man.

Most psychological studies suggest that unemployment is a risky period associated with increased experiences of stress, which may appear as a significant negative impact on mental and physical health and they are also adding that the psychological studies of job loss and the following unemployment are mainly focused on three problematic areas:

1. Deterioration in mental health (distress, increased depression, anxiety, neurotic symptoms, reducing confidence);
2. Deterioration in physical health, including drug addiction, increase in suicide attempts
3. Coping strategies and ways of coping with this difficult life situation

Every day we talk about the crisis - the economic crisis, social crisis, a crisis in the educational system, moral crisis, a crisis in the value system. In fact, those crisis don't exist, they only exist in a figurative sense. They are just manifestations of one crisis - the crisis of man. (Csampai, 2007, p. 120)

It turns out that the solution to this problem, the problem of unemployment, especially the long-term one, must be a priority not only to economical, but above all to social and educational policies since the barriers to employment are increasing over the time. It is necessary to get and mobilize the clients not only as soon they lose their jobs or leave the school, but it is necessary to systematically work with the school children especially those ones coming from families at risk of unemployment. The recommended methods are: bringing services to businesses, schools, organizations, use of media, organizing collective assistance through work clubs. The important factors for its elimination are foreign investments, particularly the use of the European Social Fund.

Factors that are even today affecting the degree and dynamics of unemployment's development are:

- A) Instability of the state and public administration's system

- B) Workers salary evaluation and its significant lag behind the EU average, but also and labor productivity growth in recent years in Slovakia
- C) Excess employment, especially in state and public administration, with a result of low productivity, quality and work organization
- D) Underdeveloped tertiary sector
- E) Lack of support for small and medium businesses
- F) Lack of funds for capital construction needs, especially in economically underdeveloped regions of Slovakia
- G) Educational and qualification structure of the economically active population, which does not correspond to the needs of the labour market
- H) Regional differences in unemployment and low labour mobility
- I) Insufficiently flexible to the needs of the labour market and not corresponding with the educational system
- J) Remained deformation in the social security system, active labour market policy and the control of black labour.

Mass unemployment brings these social problems that negatively affect the quality of Slovak society's life:

1. It threatens the stability of social and cultural society system. This is reflected in the reduction of funds to the whole society important areas and therefore to their optimal development. These are mainly the areas of :
 - Educational system
 - Healthcare
 - Social care and other support to economically non active and in social need population
 - Science and Research
 - Culture and arts

2. Increases the risk of social-pathological phenomena in society
3. It leads to social isolation of the most vulnerable social groups affected by unemployment, creating a threat to the counterculture in relation to the majority society, especially among the gypsies ethnic group.
4. This leads to the risk of social relations qualities and the value system in society

The existence and an increase of social risks can under certain assumptions foreshadow the future social crises. As the causes of social risks and crises there are currently three groups of phenomena:

1. Changing social relations in different countries as well as across the world society mainly due to the economic consequences of globalization processes. Reduction of social security and an increase of socially vulnerable groups.
2. Continuing war conflicts in the world, national, ethnic and religious conflicts, humanitarian disasters and the inability of developed countries in the world effectively solve the resulting problems.
3. Natural catastrophes, technological disasters, environmental crises, and other disasters causing more and more economic damage. By their consequences are mostly affected socially vulnerable people, socially dependents like elderly and sick, unemployed, minority communities, including immigrants, etc.

Analysis, evaluation and management of social risks and crises thus become new challenges in crisis management more broadly. In recent decades, the concept of crisis management has changed significantly. Currently the opinion is being stabilized that the term crisis management should be considered *as a coordinated systematic process aimed at prevention, elimination and removal of the impact events, threatening or likely to significantly jeopardizing the security of society, the lives and health of people, their property and the environment.*

The most common pathological phenomenon of unemployment that occurs is the poverty which is characterized by a lack of resources to meet the necessities of life. According to the political concept of poverty it is a poor person who fulfils criteria set by the State for social benefits, or social assistance. It is a condition, so called condition of social need, when the citizen cannot provide care

for himself, taking care of his home, protection and enforcement of his rights and legitimate interests or contact with the social environment, especially with regard to age, poor health, social maladjustment or loss of employment. Poverty is part of society and also a global problem faced by the world's richest countries. Inextricably linked with poverty there is also the concept of social exclusion. This concept is much broader than the concept of poverty. It presents the transfer of emphasis from financial handicap to its multidimensional nature. Social exclusion is trying to capture processes for which individuals become or remain poor. Measurements of social assistance and social services create social safety nets of social policies of individual states. Both of these factors are dependent on securing funds for social needs of its economic potential. Social assistance will be applied in situations where other resources that could help families and individuals overcome life-threatening situation are not available for them and therefore they are not able to overcome it without help.

Social work, however, understands the concept of "social assistance" much more complex. It understands it as a public and social activity that tends to care for those members of society who, in certain life situations are not able to cope on their own or even with the help of their immediate surroundings and to solve their own problems (Levická, 2004). From this perspective, we can consider social assistance as an implementation of such methods as working with individuals and families such as family therapy, occupational therapy, social rehabilitation but also advices, particularly advice accents, which does not have the same tradition in Slovakia as in neighbouring countries.

In countries with developed economies is suitable a concept of relative poverty, which is based on establishing a fixed ratio between the level of individual's income and average (or median) income of the whole society. This concept of relative poverty measurement is also adopted and used in the European Union. Poverty in the EU is described as follows: "People are living in poverty if their income and other resources are so inadequate that they cannot reach the living standards of what is acceptable in the society in which they live. Because of their poverty they may experience multiple disadvantages - of unemployment through low income, poor housing, and inadequate health care to barriers to access to education, culture, sport and recreation. They are often excluded and marginalized from participating in activities that are common to other people and their access to fundamental rights may be restricted." (Národný akčný plán sociálnej inklúzie 2004-2006, p. 57)

It is necessary that the government and other authorities have made arrangements to change the structure of the unemployed. The research shows that unemployment affects mainly people with low education. In addition to the restructuring of the economy is necessary to invest also in restructuring the unemployed through their training. Due to the increase in the overall unemployment rate and the share of long-term unemployed will increase with time shift and deepen the poverty rate and income inequality in the EU and in Slovakia. It is therefore necessary for the government to constantly monitor these processes and take measures to mitigate the impact of the crisis in this area.

Unemployment is associated with significant loss of social roles and the reduction of social prestige, the role to which it contributes. Professional role is an important component of adult identity, integrating it with the company and is associated with the inclusion of the social hierarchy. Job loss therefore leads to social degradation and human discards in some way from mainstream society (M. Vágnerová, 1999, p. 405).

As a result of poverty there is also the rise of further socio-pathological phenomena, such as **homelessness**. In the vocabulary of social security the concept defined a homeless as a citizen or group of citizens, who, in consequence of their ways of life need an extra help: no permanent address, and if there is some, they are not living there, they are unemployed and the only source of their income are mostly funds provided by the social security, or other sources.

The aim of some homeless people or people in unfavourable social situation, as they are defined by the Law 448/2008 Z.z. of social services (Z.z. is an official Law book), is the effort to achieve social re-integration. In most cases when it comes to long-term situation that persists for more than a month, or several years a man is already so accustomed to the street and their own life situation, that he resigned to change it in any way. Employment of homeless is a problem resulting from the overall situation, when their home becomes a street where they probably sleep and street becomes a part of their life also with its crime, prostitution, and there is a high probability that they become addicted in various ways.

And what is the recommendation for the practice?

First of all, the age discrimination should be repealed, the abolition of which was enforced in the European Union on 1 May 1999 in Article 13 of Amsterdam Treaty and was subsequently adopted in the Community Action Programme to combat the discrimination and also in European Union Council Directive number 200/78/ES. There was often mention the term of ageism, when employers are afraid to employ people near their retirement age, over 50's, even though they have the experience, expertise and they are efficient and reliable. They should be given the opportunity and the possibility to take courses in foreign languages, be retrained or to acquire new advanced technologies. Another option is a tax credit for employers of unemployed people, or the provision of state to the regions with high unemployment and creation of new jobs as a support for small and medium business. Another important step is to pay attention to consulting services for the unemployed, whether individual or groups, which will prepare the unemployed to be competitive in the labour market. Currently these services have been provided by work offices and therefore they should be constantly supported, but also to expand their services in more areas to the unemployed, like a legal or psychological advice.

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PROJECT FINANCING IN SLOVAK COMPANIES

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Abstract:

This paper investigates the possible resources of project financing in Slovak companies. More specifically, this paper will focus on the criteria which influence the companies by selection of resources of project financing. In order to establish a better understanding of the this problem, this paper will identify who is responsible for whole selection process of project financial resource to provide some background and depth to the research

Key Words: Project financing, financial resources, Slovak companies

Introduction

Project financing is one of a key success factor for any projects. In this research we try to identify the criteria which influence the Slovak companies by selection of resources of project financing.

According to J.D.Finnerty (2007, p. 1) project financing may be defined "as the raising of funds on a limited-recourse or nonrecourse basis to finance an economically separable capital investment project in which the providers of the funds look primarily to the cash flow from the project as the source of funds to service their loans and provide the return of and a return on their equity invested in the project."

A. Slivker (2011, p. 2) argues, that the project financing is "a method of financing where the lender accepts future revenues from a project as a guarantee on a loan."

According to Ayano (2008, p. 1) project financing is "an innovative and timely financing technique that has been used on many high-profile corporate projects."

Project financings typically include the following basic features:

1) An agreement by financially responsible parties to complete the project and, toward that end, to make available to the project all funds necessary to achieve completion.

2) An agreement by financially responsible parties (typically taking the form of a contract for the purchase of project output) that, when project completion occurs and operations commence, the project will have available sufficient cash to enable it to meet all its operating expenses and debt service requirements, even if the project fails to perform on a account of force majeure or for any other reason.

3) Assurances by financially responsible parties that, in the event a disruption in operation occurs and funds are required to restore the project to operating condition, the necessary funds will be made available through insurance recoveries, advances against future deliveries, or some other means (Finnerty, 2007).

Generally the top-managers provide a control and support of resources usage, which are supervised by a functional manager (Tukel, O.I., Belassi, W, 1996). The level of support and control has to be determined according to the needs of the industry or project specification, and always varies from company to company. One of the important issues of the top-management is to create a better communication between all managerial levels and provide a communicational support and eliminate agency conflicts and agency costs. The responsibility for the selection of financial resources is an intrinsic part of the research described in the second part of this paper.

Among the standard resources of project financing in Slovakia we can include:

- external resources,
- internal resources (own capital),
- alternative resources (for detailed description see Fig. 1).

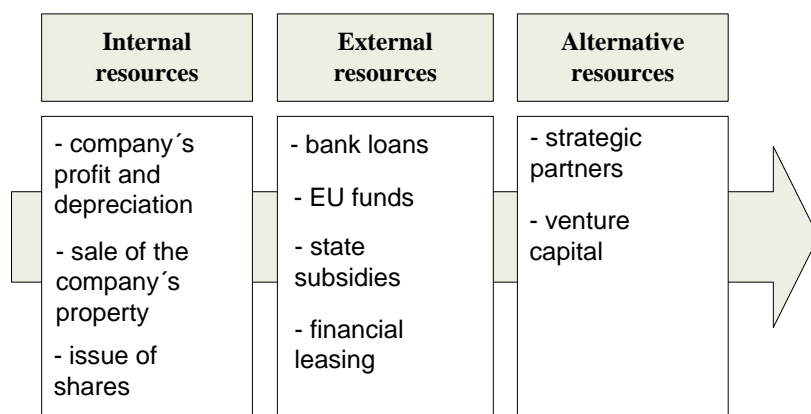


Fig. 1 Selected sources of project financing in Slovakia

Source: own processing

In practice, most projects are financed by a combination of the sources mentioned above.

Subsidy is “a benefit given by the government to groups or individuals usually in the form of a cash payment or tax reduction. The subsidy is usually given to remove some type of burden and is often considered to be in the interest of the public.” (Manteaw, 2012)

A subsidy is a financial reimbursement of contribution from the public budget – at national level (state or municipal budget) or from the EU budget at international level. The subsidies coincide with the company's own sources – it extends the company's own capital. Subsidies can be a significant source of project funding.

Bank loans are most used to funding of asset acquisition rather than to direct project financing. Innovative projects are connected with risks, which have to be compensating with guarantees as such as history of company, solvency, and project proposal.

In 2011, there were 14 commercial banks and 15 branches of foreign banks which operated in Slovak financial market. Nine of them offer medium- and long-term financing of construction, purchase, extension and reconstruction of real property. Documents required by the banks for project evaluation are mostly following:

- business plan stating the project description and location,
- overall project cost budget,
- project realization schedule,
- information about the permissions - planning permit, building permit,
- information about building contractor,
- ownership title and cadastral map,
- expert's opinion (in the event of existing real property),
- information about project yields,
- information about costs of real property operation,
- client's participation in the total project costs (the amount of own resources) (www.tatrabanka.sk).

Bank loans are often used by Slovak companies as a source of co-financing of the projects supported by European Union.

Financial leasing is a simple way to asset acquisition. It is suitable for small and medium sized companies with short-term history.

Issue of shares is typical for joint-stock companies. This is the method of basic capital increasing. This way of financing isn't used in small- and medium-sized companies, which legal form is rarely in form of joint-stock company.

Venture capital is financial resource provided to growth start-up, high risk or high-potential companies. Venture capital is generally used to projects uncertain success (high risk and high valuation). Venture capital may take the form of seed financing, start-up financing or business angels.

Each project is unique, however, parts of projects may be included in the same class, for such reasons as the required resources and network of tasks. In this case, the required resources (including the financial resources) can be estimated using the past experiences of the enterprise that made the projects (Relich, 2010).

For the purposes of this paper we will use three phases within the project life cycle: project definition (initiation) and project planning, project execution and control, and the phase of project evaluation and closeout. Each of the three phases includes different tasks, behaviors and skills that are necessary to be successful. During the project initiation project manager have to initiate with the problem, create a business case which should provide the information with possible solutions of the problem and get a feasibility study. Choosing the most suitable solutions and proposing recommendations before implementation to form a project and find a people with whom the project will be run and maintain. An inherent part of the project initiation is the financial analysis of the costs and benefits including a budget. This phase includes also the selection of an appropriate way of project financing. The process of selection depends on financial conditions of each company and on the total costs of the project. The availability of the financial resources necessary to cover all project costs varies from type of the project.

Factors influencing the selection of type of resource in project financing

Our research was realized in 2012 in a sample of 79 Slovak companies and was an intrinsic part of the project VUGA N. I-11-001-05 with the title “The possibilities of project financing in conditions of Slovak companies.” The research problem in this paper is to investigate which criteria influence the Slovak companies by selection of resources of project financing.

Research Design and Data Collection

The method used in the research was in the format of a questionnaire consisting of 15 questions. The questionnaire was delivered via e-mail to Slovak companies. A comprehensive survey was design mostly for identification of criteria which influence the selection of type resource within the process of project financing. The target Slovak companies were selected randomly from various industries.

Survey Findings on project financing

Of the organizations surveyed, 43% were micro companies (< 10 employees), 22% were large companies (> 250 employees), 24% were small companies (< 50 employees) and 11% were medium-sized companies (< 250 employees). The companies were asked to identify their industry which is detailed described on the chart 1.

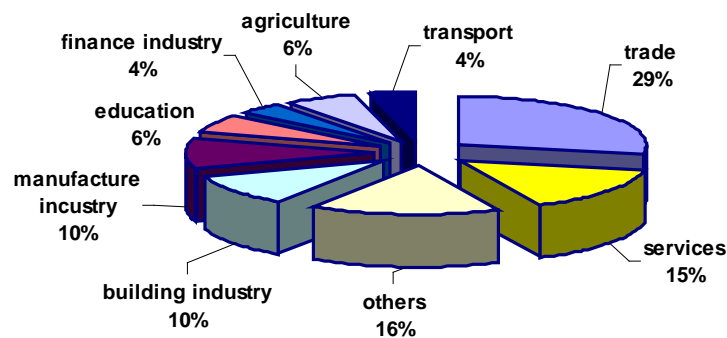


Chart 1 Types of industries of the respondents

Source: survey data

The respondents were asked to identify the number of project realized in 2011 in their companies. Most of them (29% realized one or two projects), 15% completed three or four projects and 13% finish five or six projects in 2011. These projects mainly focused on implementation of new products or systems.

The respondents were asked to identify the person responsible for whole selection process of project financial resource. A half of the respondents (50%) indicated that this person is the company director, 17% of companies stated that it is financial manager, only 8% of respondents confirmed the responsibility of project manager.

The analysis of questionnaire identified that the most important criterion for the Slovak companies by the selection of financial resources are the total costs (58%). Several respondents (19%)

stated that their own previous experience with the financial resource is important. For the rest of respondents were important for example the administrative seriousness (8%) and the experience of other companies (4%).

According to our survey 50 % of Slovak companies used in 2011 the external resources. More specifically, there were bank loans (39 %) and the resources from European Union (27 %). More detailed description we can see on the chart 2. Finally, only 36 % of the respondents preferred internal resources (80 % company's profit and depreciation) and 14 % the alternative resources.

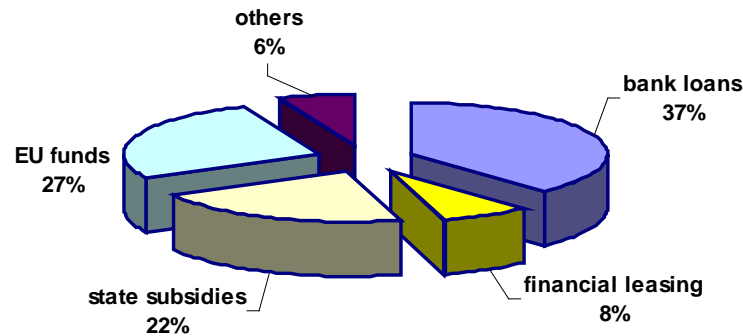


Chart 2 Types of external resources
Source: survey data

The respondents (65%) also confirmed that they are good informed about existing resources of project financing. We conclude from our research that the websites of state institutions and electronic or printed media can be considered as a relevant source of information for asked companies.

The data returned by the respondents provides some interesting information with respect to the propositions that were made in designing the questionnaire. According to the responses, the Slovak companies prefer the external financial resources and they are focused on their own experience and total costs.

Conclusion

The project financing represents a complex and difficult problem. The key objective is to select an appropriate way of project financing. It depends on financial conditions of each company and on the total costs of the project. The availability of the financial resources varies from project to project.

Project finance permits countries and companies to build new infrastructure, to develop new products or to develop new technologies. It allows increasing growth and development of each country. Without project finance, many interesting and important projects may have never been undertaken.

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ALTERNATIVE METHODS OF JUDICIAL PROTECTION AND DISPUTE RESOLUTION IN ADMINISTRATIVE LAW

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Abstract:

The administrative court is not the only and main method, instead it is just one of the methods for judicial protection and dispute resolution and the final one which solves the disputes that have not been solved by a private party and an authority within an out-of-court stage.

Key Words: Administrative procedure, alternative dispute resolution, administrative court, effective remedy

Introduction

The state administration issues administrative acts and references, implements actions and concludes the agreements of public law that impact the daily life of individuals, therefore efficient methods are required for the restoration of the rights that have been unfairly and unlawfully violated and the lawful interests as well as for the dispute resolution. As it follows from Articles 6 and 13 of the European Convention for the Protection of Human Rights and Fundamental Freedoms and Articles 89 and 92 of the Satversme [Constitution] of the Republic of Latvia, the state has to provide as efficient as possible protection of the fundamental rights of persons.

The efficiency of judicial protection and dispute resolution within the administrative procedure presents one of the cornerstones of a democratic and judicial state. The unjustified long hearing of cases contradicts also the very essence and idea of the administrative procedure which is the timely and efficient hearing of cases. This also violates the principle enforced by the European Convention of Human Rights and Fundamental Freedoms and the Constitution of the Republic of Latvia that a case has to be heard within a reasonable time. At present the administrative court in several European countries does not provide efficient protection of people.¹⁰⁰ At the administrative court of Latvia the terms of hearing cases at a single court instance can take as long as a few year. The opening of new courts and the increase of the number of judges is not the most rational tool for improving the quality of the administrative process and eliminating the overload of court. The state has to improve the efficiency of both the court process and also the administrative process within an authority and the possibilities for judicial protection and dispute resolution presenting alternatives to the court for the purpose of securing a private party's rights and judicial interests in compliance with the basic principles of a judicial and democratic state.

Main Text

The use of alternative methods for judicial protection and dispute resolution presents a logic solution of the development of administrative law. In order to attain the goal defined in the Administrative Procedure Law, i.e. to ensure the judicial, accurate and efficient application of the basic principles and legal norms of a democratic, judicial state, as well as an independent, objective and competent control over the operation of the executive power, actual and efficient implementation tools are necessary.

A high quality administrative procedure is aimed not only at the correct application of legal norms to actual circumstances, but also at the efficient solution of the particular situation. While taking the role of an observer within an administrative procedure in an authority, a private party becomes

¹⁰⁰ Alternatives to litigation between administrative authorities and private parties: conciliation, mediation and arbitration: Proceedings of multilateral conference. Lisbon (Portugal), 31 May–2 June 1999/ Council of Europe. Strasbourg: Council of Europe Publishing, 2000, p.20.

active at the court procedure only. Therefore, the administrative procedure needs to be rational, enabling consensus and focused on the fair result.

Along with the development of the participation democracy the principle of good governance includes also the principles of co-participation and co-responsibility of a private party, and makes it necessary to establish a modern administrative procedure in an authority where hearing is replaced by the concept of negotiation.

The concept of negotiation can be successfully implemented by alternative methods for judicial protection and dispute resolution. Their application can ensure the self-stabilisation function of the administrative procedure by securing the predictable use of rights and fulfilment of obligations that is not distant from the moment of the actual necessity.

Delayed justice is not comprehensive justice,¹⁰¹ however, a longer administrative procedure in an authority compared to the current one possesses a higher value of democracy and a judicial state, and usually it is shorter than a court procedure.

The alternative method for judicial protection and dispute resolution can be defined as a technique for dispute resolution (except litigation) by means of which timely and efficient protection of fair and judicial rights and resolution of disputes can be achieved with or without involving an intermediary based upon the actual and legal circumstances of the case. The appeal within the framework of the state administration, quasi court, arbitration, prosecutor, ombudsman, mediation and reconciliation are all supplements to the conventional administrative procedure both in an authority and at the court aimed at making the procedure more efficient.

It only in case of disagreement when methods for judicial protection and dispute resolution are required for the participants of the administrative procedure to settle their conflict in a rational manner that is acceptable to the society and supervised within the framework of the conflict law. The current authority of the resolution of administrative disputes has caused the overload of the administrative court,¹⁰² however, alternative methods are aimed not only at relieving the load of courts, but also at providing the methods for judicial protection and dispute resolution that are most appropriate for resolving administrative disputes and promoting the public trust to the state administration. Alternative methods are independent legal and social values, a component of the legal awareness and culture that help to create a state that is not the "judge's state",¹⁰³ but a judicial and democratic state instead.

The pluralism of methods for judicial protection and dispute resolution follows from Article 13 of the European Convention of Human Rights and Fundamental Freedoms and Article 89 of the Constitution of the Republic of Latvia, i.e. the fundamental right to protect one's rights and to solve administrative disputes by employing various judicial methods.

An administrative dispute may be based upon factors of both legal and social character, e.g. the lack of trust, knowledge and cooperation, therefore the judicial character of the procedure is not the only exclusive standard that an authority has to follow. The more difficult the relationship between the state administration and the members of the society, the more specific the character of disputes that emerge. Besides, the court is not always able to secure a timely and fair resolution of a dispute, therefore the parties to a dispute should have a possibility to eliminate their disagreement by employing the method that is most appropriate for the actual and legal circumstances of the individual case, attaining a judicial and fair resolution in this way (the principle of accessibility of justice).

The right to access to various judicial methods are still not absolute. The goal of the system of judicial protection and dispute resolution is to ensure efficient and fair resolution of a dispute. The state may, at its own discretion, select the types of methods that comply with the legal and social necessity and which yield considerable public benefit and can be provided by reasonable resources.

The use of alternative methods for judicial protection and dispute resolution may be established as voluntary or mandatory either in a law or on the basis of a law.

¹⁰¹ Carper D.L., McKinsey J.A., West B.W. *Understanding the Law*. Fifth Edition. Ohio: Thomson West, 2008, p.188.

¹⁰² Luhmann N. *Legitimation durch Verfahren*. Neuwied und Berlin: Luchterhand, 1969, p.101.

¹⁰³ Hefe O. *Taisnīgums. Filosofijas ievads. Mūsdienu domātāji*. [Justice. Introduction to philosophy. Modern thinkers.] Riga: Apgāds Zvaigzne ABC, 2009, p.58.

Appeal within the framework of the state administration

The appeal within the framework of the state administration is the alternative method that is used most often. The following objectives of the appeal have been defined in legal texts – judicial protection during the pre-court stage, the provision of an opportunity for the state administration to correct its own mistake and the relief of the load of the administrative court.¹⁰⁴ However, taking into account the principle of resolution of a dispute and the condition that other alternative methods can be integrated in the appeal procedure, the author has defined an additional objective of the appeal, in particular, the provision of the possibility for the participants of the administrative procedure to come to an agreement as regards the resolution of the dispute, thus preventing the submission of an application to the court.

The appeal has to be a procedure of review of a private party's objectives that is compliant with the public interest, within which an authority acts in an objective and responsible manner, promoting trust and establishing the legal certainty as fast as possible. The principles of good governance and efficiency oblige the appeal authority not only to establish the illegal character of the initial administrative act or, to the contrary, its legal character, but also to strive to achieve the consensus between the participants of the case as to the most fair and judicial solution whenever it is a viable option. Not all the cases of appeal include an infringement of rights and the illegal character of an administrative act or action (error), although this does not mean that there is no dispute which a private party could submit to the court. An authority can achieve this in direct negotiation with the relevant private party by explaining the reasoning behind its decision or by employing an alternative method.

In Latvia the written procedure of appeal prevails, therefore the law should provide for cases when this can be an oral procedure, or provide for a possibility for the participants of the administrative procedure to choose. An oral procedure ensures the private party's participation, the transparency of the state administration and it would be useful, for example, if the dispute is not related to the interpretation of the legal norms and the parties to the procedure are willing to reconcile. A written appeal procedure does not ensure the direct communication and fast interaction between the parties to the administrative procedure.

The compliance with the procedure of appeal may be optional or mandatory, still the mandatory character of the appeal is not absolute and allows for the following exceptions in the administrative procedure: (1) when there is no superior authority or this is the Cabinet of Ministers; (2) if the exception is provided *expressis verbis* by the law; (3) if a private party requests to omit the procedure of appeal and to permit to submit application to the court at once;¹⁰⁵ (4) if the requirement to comply with the procedure of appeal is disproportionate or does not depend on the wish of the private party; (5) if the private party can justify the inefficiency of appeal or if the compliance with it can cause considerable infringement of the private party's and public rights or interests.

The mandatory appeal restricts the person's rights to a fair court, and any restriction of the fundamental rights has to be provided for in a law or based upon a law. In Latvia the Administrative Procedure Law and the State Administration Structure Law do not stipulate this restriction clearly enough, therefore, one cannot agree that the conditions of the mandatory procedure of out-of-court review are applicable to the cases of the dispute over public law contracts.¹⁰⁶ Prior to applying to the court a private party is obliged to object against the initial administrative act or actual act of the authority.

If regulatory acts do not define the authority of appeal, Part Two of Article 76 of the Administrative Procedure Law should provide for the optional appeal with the issuing authority of the

¹⁰⁴ Singh M.P. *German Administrative Law in Common Law Perspective*. 2nd edition. Berlin: Springer, 2001, p.221; Cowan D.S., Halliday S., Hunter C., Maginn P., Naylor L. *The appeal of internal review: law, administrative justice and the (non-) emergence of disputes*. Oregon: Hart Publishing, 2003, p.4; Buck T. *European methods of administrative law redress: Netherlands, Norway and Germany*. Prepared for the Department for Constitutional Affairs. DCA Research Series 2/04, November 2004, p.39; Briede J. *Administratīvā akta apstrīdēšana: Administratīvā procesa likuma 75.–81. pants. Administratīvais process: likums, prakse, komentāri*. [Appealing against an administrative act: Sections 75-81 of the Administrative Procedure Law. Administrative procedure: law, practice, comments] Riga: Latvijas Vēstnesis, 2005, p.183.

¹⁰⁵ Meulen B.M.J., Litjens M.E.G., Freriks A.A. *Prorogatie in de Awb. Invoeringsevaluatie rechtstreeks beroep*. Haag: WODC DEN, 2005, p.26.

¹⁰⁶ Višķere I. *Publisko tiesību līgumi un to kontrole administratīvā procesa kārtībā*. [Public law agreements and their control by applying the administrative procedure.] *Jurista Vārds*, 3 February 2009, vol. 5, p.21.

administrative act. For the appeal procedure to be efficient, an authority should establish a special appeal commission that would evaluate appeal applications in an objective manner and independently of the issuing authority of the administrative act. The necessity of this type of authority is particularly essential if the issuing authority of an administrative act defines it as mandatory.

For the improvement of the quality of the appeal Part Two of Article 76 of the Administrative Procedure Law should also provide for a general possibility that it is not the supreme authority according to the hierarchy that reviews an appeal application, but in cases that are of particular importance to the society or complicated it can establish a permanent or *ad hoc* appeal commission. An *ad hoc* authority could be necessary if, for example, the knowledge of interbranch experts is required for reviewing an application and the relevant authority does not possess it at the required quality level. There could be officials of various ministries, independent experts, judges, attorneys at law, law researchers, etc. among the members of the appeal commission. The commission could issue an administrative act itself or provide a legally not binding proposal to the issuing authority of the administrative act.

The appeal authority may not be of political character, or there is a risk that a political official may adopt a decision within the administrative procedure that is not based on legal, but political criteria instead. If the above principle is implemented in the direct state administration in Latvia, it does not work in the indirect administration. The Council of a regional municipality that consists of political officials adopts administrative acts in compliance with Article 37, Paragraph 3 of Article 41 and Article 47 of the Law "On Municipalities". The deciding power has merged with the executive power at the level of municipalities. In municipalities administrative acts should be adopted by the administration of the municipality and the council of the regional municipality should decide on political issues related to the strategic development of the municipality. Therefore, a new Law on Municipalities should be adopted and it should distinguish between the different branches of the municipal power.

Quasi court

Quasi court can present an alternative to the appeal or the administrative court. Historically and also at present the quasi court in the administrative law is recognised as an efficient method for judicial protection and dispute resolution in the countries of both the law of the continental Europe and the Anglo-Saxon law,¹⁰⁷ although it is traditionally associated with an Anglo-Saxon law institute.

The authority based affiliation with the state administration is the most important feature that distinguishes the quasi court from the administrative court, still the functional importance and impartiality are more important than the authority based affiliation. A deviation from the principle of the distribution of power is admitted and state administration authorities empowered by the law may act in a similar manner to the court for attaining a goal that is compliant with the public interest if the usurpation of the power does not take place and the mutual supervision is ensured.

Article 6 of the European Convention of Human Rights and Article 92 of the Constitution of the Republic of Latvia covers not only the classic court authorities, but also quasi courts.¹⁰⁸ The above legal norms are not categorical and do not provide strictly that the rights to a fair and open hearing of the case can be implemented by applying to the court only.

For the purpose of recognising the quasi court an independent and impartial authority it has to comply with the following criteria: (1) its status has been defined in the law; (2) the procedure of appointing its members, their premature termination and suspension does not cause any doubt as to their impartiality; (3) members are independent of the executive power, the parties to the case and any other influence; (4) the process of the review of the case is fair with appropriate procedure guarantees; (5) legally binding resolutions are usually adopted by the college.¹⁰⁹

¹⁰⁷ Robson W.A. *Justice and Administrative Law*. London: Macmillan & Co, 1928; Cane P. *Administrative Law*. Fifth edition. Oxford: Oxford University Press, 2011; Pranevičienė B. *Kvaziteismai administracijos kontrolės sistemoje*. Vilnius: Lietuvos teisės universitetas, 2003; Bilak D.A. *Administracine Justicija Lietuvoje. Vertinimas. (Administrative Justice in Lithuania an Assessment)*. Parengė Jungtinių Tautų vystymo programa. Vilnius: UNDP, 2003.

¹⁰⁸ Judgements of the European Court of Human Rights in the cases: 4451/70 *Golder v. The United Kingdom*, para. 32; 2614/65 *Ringeisen v. Austria*, para. 95.

¹⁰⁹ Judgements of the European Court of Human Rights in the cases: 9273/81 *Ettl and Others v. Austria*, para. 34., 38; 19178/91 *Bryan v. the United Kingdom*, para. 37; 2614/65 *Ringeisen v. Austria*, para. 95; 2614/65 *Salabiaku v France*, para. 28.

In Latvia most cases are heard on three levels of administrative courts, i.e. the first instance in the Administrative District Court, the appeal authority at the Administrative Regional Court and the cassation instance at the Department of Administrative Cases of the Supreme Court Senate. This model was established based upon the experience of other countries and the historical tradition, but not on the basis of the law doctrine compliant with the social reality. The accessible judicial protection level at the development stage of democracy can be valued positively, still it has to be ensured in compliance with the actual situation taking into account the necessity for the comprehensive efficiency of the system.

When the administrative justice is developed the length of the democracy development and consequences have to be taken into account. The experience of the West European countries confirms,¹¹⁰ that the formation of democracy and the rule of law, the responsible state administration and the public legal culture is a long process. The number of administrative disputes will continue to grow during coming years, and this is attested by the statistics of recent years. The increase of the number of judges and the reduction of the accessibility of the court cannot be endless and disproportionate, therefore, over long term the capacity of administrative courts will be insufficient for ensuring timely hearing of all the cases. The overload of the court presents the shadow side of democracy development.

The administrative justice should be diversified in Latvia basing its development on the traditional litigation and the quasi court procedure. The administrative justice should be made more informal and efficient without reducing the access to the judicial protection system. In the medium term specialised quasi courts should be established for the major categories of cases, for example, taxation, municipal cases. In the long term general and specialised quasi courts should be established as the first stage of the administrative justice, at the same time maintaining just two levels of administrative courts, i.e. the Administrative Regional Court and the Supreme Court.

The quasi court possessed several advantages in comparison to the court, e.g. the informality of the process, specialisation, accessibility that ensure efficient private parties' judicial protection and dispute resolution. Quasi courts can hear a high number of cases within a comparatively short time period. Slightly distant legal control from the point of view of time ensures higher quality of the administrative procedure.

Arbitration

Arbitration is a method that is similar to the quasi court from the functional point view, but different from the authority point of view; this is a typical human rights institute and its use in the administrative law is limited.

In the Recommendation Rec(2001)9 of the Committee of Ministers of the Council of Europe to Member States on alternatives to litigation between administrative authorities and private parties and its Explanatory Memorandum the Member States of the Council of Europe are encouraged to use the arbitration law institute not within the administrative procedure, but between an authority and a private party in the private law.

The arbitration as a private law authority lacks the legitimate empowerment to cancel or amend the acts of the public power. An authority and a private party cannot change the procedure of judicial protection and dispute resolution stipulated in the law and delegates the authority to decide on the legality and repeal of public legal acts to a private party. However, its use cannot be fully excluded.

An authority and a private party may submit any dispute for resolution to the arbitration which adopts a resolution of the character of recommendation. Besides, only the law can stipulate that the arbitration can evaluate the disputes concerning reparation related to the administrative law.¹¹¹ If the arbitration can impose legal obligations upon and establish rights for the state, it is admissible within the administrative procedure. In this case the arbitration does not need empowerment for evaluating the legality and repeal of an actual action and an administrative act because this has been done by the authority or court in advance; however, based upon the internal conviction, it has to evaluate the existence of the damage, its scope and the causal relationship between the illegal action and the damage. In the course of evaluating the length of the infringement of rights, the character and reversibility of the caused consequences, the arbitration determines what kind of reparation would be most fair under the particular circumstances. For this purpose Part Four of Article 93 of the

¹¹⁰ Phillips O.H. Constitutional and Administrative Law. Fifth edition. London: Sweet & Masecweill, 1973, p.497.

¹¹¹ Poudret J.F., Besson S. Comparative law of international arbitration. 2nd edn. London: Sweet & Maxwell, 2007, p.312.

Administrative Procedure Law and Article 22 of the Law on Reparation of Damages Caused by State Authorities have to be amended by stipulating: „A private party may appeal a resolution by an authority regarding reparation to the court or, by concluding the arbitration agreement with the authority, to submit the issue on the type and amount of reparation for resolving at the arbitration. The arbitration resolution can be appealed with the Administrative Regional Court.”

The arbitration and quasi court cannot be recognised as an ombudsman because, different from the members of the arbitration, the parties to the administrative procedure cannot select a person who will perform the ombudsman’s obligations, and different from the quasi court, it does not adopt a legally binding resolution.

Ombudsman

The ombudsman is a state official who has been appointed not only by the legislator (parliament), but also the executive power (the Cabinet of Ministers or a ministry) or the court (the Council of Justice) and established by the constitution or the law and who, upon its own initiative (which makes it different from the court and the quasi court) or upon a claim by a private person on the legality of the acts by the state administration and court system authorities and their compliance with the human rights and the principle of good governance, carries out independent and impartial investigation, promotes reconciliation and provides suggestions for the elimination of the infringement of the private parties’ rights and the improvement of the operation of the state administration and courts.

The legal institute of the ombudsman is characterised by a few essential features describing its essence and distinguishing it from other methods for judicial protection and dispute resolution:

- 1) *independence* – the ombudsman has to be independent of both whom it supervises and who appoints it to the post. The independence is not ensured by the authority alone. The individual’s personal traits of character are much more important and they include competence, honesty, attitude to people and communication skills. Gramatic amendments providing for including the ombudsman in the Constitution of the Republic of Latvia, would not change its independence guarantee *de facto*. The Constitutional court of Latvia has clearly recognised the status of the ombudsman as an independent authority and its independence guarantee.¹¹² Amendments can just arrange the internal system of the Constitution;
- 2) *the recommendation character of conclusions* – the opinion expressed by the ombudsman is comparable to the decisions of the constitutional court from the point of view of authority and competence, however, in the countries with young tradition of democracy the ombudsman faces the challenge of ensuring the fulfilment of its conclusions. In Latvia, the attitude by the state administration to the ombudsman not only encumbers the daily work of this authority, but also imposes a long-term threat to its importance and usefulness. The elimination of the above situations is, first and foremost, the responsibility of the ombudsman itself; it has to be an active defender of its conclusions. There are several ways how the ombudsman can promote the fulfilment of its decisions, in addition to its authority and personal authority: (a) by making the results of its work public in a comprehensive and regular manner; (b) by notifying the Parliament and the Cabinet of Ministers on the cases of non-fulfilment; (c) by demanding explanations from authorities when recommendations are not fulfilled; (d) by applying to the administrative court and (e) by initiating disciplinary cases and criminal cases on the illegal acts of officials;
- 3) *facultative method for judicial protection and dispute resolution* – the judicial protection and the initial selection of the most appropriate method may not cause negative legal consequences for a private party, therefore if a private party is not satisfied with the ombudsman’s conclusion it can appeal against the resolution or the act of an authority with the court. Contrary to the principle of equality and the foreign practice, in Latvia in compliance with Part Three of Article 24 of the Ombudsman’s Law, the initiation of an examination case does not stop the accounting for the procedure terms established by the law. Parallel to the submission of a claim to the ombudsman a private party is forced to submit an application to the court, thus it is not possible to select the

¹¹² On the compliance of Part Five of Article 19 of the Law on the Budget and Financial Management, Part Two of Article 44 of the Law on the State Audit Office and Part Two of Article 19 of the Ombudsman Law with Articles 1, 83 and 87 of the Constitution of the Republic of Latvia: Judgement of the Constitutional Court of the Republic of Latvia (25 November 2010) in the case No. 2010-06-01. *Latvijas Vēstnesis*, 30 November 2010, vol. 189.

method for judicial protection and dispute resolution that would be most appropriate to the particular conditions. Two judicial protection and dispute resolution methods are employed for the resolution of a single dispute at the same time. This situation contradicts the principle of efficiency and does not relieve the load of the administrative court. Amendments have to be made in Part Three of Article 24 of the Ombudsman's Law allowing a private party to turn to the court following the receipt of the ombudsman's resolution on the initiation of the examination case or conclusion. Moreover, the Ombudsman's Law should stipulate that the ombudsman can evaluate claims on the issues regarding which litigation has been initiated before the hearing of the case at the court has been completed;

- 4) *an individual or collective post* – in Latvia the ombudsman's institute is monocratic which means that a single ombudsman is appointed. In the countries where there is just a single ombudsman, the ombudsman's institute has a vast range of responsibility and, thus a higher load. It is unavoidable that in such circumstances it has to define certain issues as priorities. In the countries where there are several ombudsmen, more financial resources are required for ensuring their operation, it is difficult to mark the borders of responsibility and to ensure coordinated protection of human rights. The model of the ombudsman's system where the ombudsman's duties are performed by several persons, who ensure the coordinated protection of human rights, at the same time splitting the responsibility fields in equal shares among several persons, is more efficient. Two persons should be appointed for fulfilling the ombudsman's obligations in Latvia because the scope of responsibility is too broad for one person; therefore, Part One of Article 3 of the Ombudsman's Law should provide for the appointment of two persons for the performance of the ombudsman's obligations: one of them would be responsible for human rights and the other would assume the responsibility for good governance. In this way a considerable contribution to the judicial protection and relieving the load of administrative courts would be secured both in short and long term;
- 5) *authority based accessibility* – in comparison to the state administration and the court the ombudsman is more accessible for private parties. The ombudsman's efficiency may not be below the level that is required by the law from the state administration and the court. For example, a state fee does not have to be paid, there are no formal requirements as to the claim, the ombudsman also provides consultations. An application to the ombudsman can be submitted both in writing and verbally, similarly to any other state authority, unfortunately, the information on the ombudsman's website provides a narrow interpretation of Part One of Article 23 of the Ombudsman's Law (the Ombudsman's office, n.d.) and it is specified that the application can be submitted only in writing. The criterion for the submission of an application is the ability to be a subject of law and not the capacity of a private party. A claim may be submitted also by underage persons and incapacitated persons if they are able to submit and to prepare an application of the required quality level. An application may be submitted by a private party whose rights or judicial interests are violated by a resolution or act of an authority. Applications that are submitted by other persons or are anonymous can serve as the basis for carrying out examinations based upon the ombudsman's own initiative.

Review of applications is the ombudsman's traditional function,¹¹³ which takes a considerable time of its time. The ombudsman has the discretion to decide whether an examination case should be initiated and whether the circumstances that are referred to in the application should be investigated. After having reviewed a person's application the ombudsman decides on the initiation of an examination case and it may refuse to do so if it is not competent in the particular case or if there is no necessity. For example, an application may be based on a private party's insufficient knowledge, lack of understanding on the legal regulation or a resolution or act of an authority, emotions or other circumstances which the ombudsman may eliminate without initiating a case in bilateral or trilateral negotiations or by a written reply.

¹¹³ Stuhmcke A. Ombudsmen and Integrity Review. Grām.: Administrative Law in a Changing state: Essays in honour of Mark Aronson. Edited by Harlow C., Pearson L., Taggart M. Oxford: Hart Publishing, 2008, p.354; Eklundh C. The Swedish Parliamentary Ombudsman System. Grām.: Hossain K., Besselink L.F.M., Selassie H.S.G., Völker E. Human rights commissions and ombudsman offices: national experiences throughout the world. Hague: Kluwer Law International, 2000, p.427.

The principle of good governance applies not only the state administration, but also to the ombudsman, whose actions cannot be left outside any control. A private party may not appeal against the ombudsman's resolution at the court, however, it can appeal against it with the ombudsman itself. In such cases the ombudsman can establish a collegial application for the review of the appeal application. The final resolution is when a private party addresses its application to the authority that has established the ombudsman and can decide on his/ her suitability to the position.

In Latvia the ombudsman can supervise not only the authorities that are included within the state administration according to the authority structure. For the purposes of the Administrative Procedure Law the definition of an authority should be applied considering its functional aspect. The ombudsman may examine also the acts of private parties to whom the functions of the public power have been delegated.

The ombudsman does not supervise the work of the administrative court, however, its authority should be expanded by respecting the principle of the division of power, the judge's independence and considering the benefit to the society. The ombudsman may not interfere with the courts judgement, still it could supervise courts, first when the court operates as a state administration authority from the functional point of view, second in relation to the organisation of the court's work (the work of chancery), and third, similar to the Minister of Justice, it could initiate a disciplinary case against the judge.

The ombudsman's work is not just directed to the authority and the improvement of its work, but also towards the education of private parties and the society, however, the ombudsman criticizes the state administration and not a private party.

The modern concept of the ombudsman's law institute comprises two equally important functions: prevention and resolution of disputes.

Under the conditions of the pluralism of the methods for judicial protection and dispute resolution the ombudsman's mission is not just to fight the consequences or to review applications, which has been its traditional task until now, but also to prevent eventual problems in the operation of the state administration that exist only theoretically. The appeal, quasi court or court prevent individual errors, and the ombudsman has to deal with systemic errors prior to the emerging of a formal dispute between a private party and an authority. The first above category of authorities look back, however the ombudsman has to look forward in the future.

In Latvia, the ombudsman considers the provision of a conclusion on an examination case as the basic tool of its operation without any reason. The result index of quality is the number of reconciliations between a private person and authority; moreover, the ombudsman's office has to become an authority that is similar to the State Probation Service and where specialised mediators in the administrative law develop.

Mediation and reconciliation

The ombudsman is the pioneer of mediation and reconciliation in the administrative law, and the candidate to this post should possess knowledge on the methods and the skills of their application. The law researchers have not agreed on a uniform definition of mediation.¹¹⁴ The concept is used in its narrow sense according to which a mediator is just leading the process and does not express any opinion (process oriented), and in its wider sense where a mediator suggests to the participants to discuss its view of the most fair, long-term and most appropriate solution (content oriented). The supporters of the narrow interpretation of the concept of mediation distinguish between mediation and reconciliation, however the supporters of the broader interpretation do not. The author distinguishes the concepts "mediation" and "reconciliation" because the difference in the manner of achieving the resolution is essential enough for viewing both as different methods between which the parties to a dispute may choose. In the Recommendation Rec(2001)9 of the Committee of Ministers of the

¹¹⁴ Alternatives to litigation between administrative authorities and private parties: conciliation, mediation and arbitration: Proceedings of multilateral conference. Lisbon (Portugal), 31 May–2 June 1999/ Council of Europe. Strasbourg: Council of Europe Publishing, 2000, p.77; Tolsma H.D. How can mediation be implemented in the current administrative decision-making process? Grām.: Quality of Decision-Making in Public Law. Studies in Administrative Decision-Making in the Netherlands. Edited by Graaf K.J., Jans J.H., Marseille A.T., Ridder J. Groningen: Europa Law Publishing, 2007, p.69; ; Spencer D., Brogan M. Mediation law and practice. New York: Cambridge University Press, 2006, p.3; Trosens A. Kas pamudina konfliktējošās puses izmantot mediāciju. [What encourages conflicting parties to use mediation.] *Jurista Vārds*, 24 May 2007, vol. 17/18, p.7.

Council of Europe to Member States on alternatives to litigation between administrative authorities and private parties and its Explanatory Memorandum the explanation of methods has been misplaced and is not consistent.

Mediation and reconciliation may be used also in the cases where parties are in unequal positions from the point of view of their knowledge and possibilities, because this is the reason why there is a mediator who levels out any differences and monitors the situation to avoid that the superiority of one party does not depress the other and does not impact its decision-making ability. The mediator employs several strategies of leading the process for minimising the difference between the parties' statuses, and if this is not successful and the superiority of any of the parties emerges within the procedure, the mediator should interrupt the mediation procedure. This problem is less pronounced in the reconciliation because the reconciliator has better opportunities for levelling out any inequalities basing upon its knowledge, opinion and proposals, by its activity.

Mediation and reconciliation may be used in all the administrative disputes because the goal of the principle of a judicial state is not the unilateral power, but judicial relationship instead. However, depending on the essence and the circumstances of a dispute a particular method can be more appropriate for resolving disputes than another one. Mediation is more efficient in the disputes over interests and the reconciliation is more efficient in judicial disputes. Mediation is directed towards the mutual conciliation of the interests of the parties to the dispute and the achievement of the conciliation, however, the reconciliation includes the evaluation of the rights of the parties to the dispute and the provision of the opinion on the most appropriate rights of the parties to the particular dispute. The fields of the administrative law where mediation is used more often have emerged in practice: these are the disputes that are related to the environment, the territory planning and building law, the tax law, the social law, the competition law, remuneration, civil service, etc.

In the case of the issue of both a free and mandatory administrative act, mediation or reconciliation may be used; just the goal of the application of methods is different in each case. In the case of a mandatory administrative act the goal is the achievement of the agreement on the accurate actual circumstances and the applicable law, and in the case of a free administrative act not only the actual circumstances have to be identified, but also the rights or interests of the public and an individual have to be balanced in an accurate way. In both cases the decisions and acts of an authority have to be accurate and correct to impose the least restriction of the individual's interests.

In the mediation and reconciliation procedures the interests or rights of a private party (fairness) are not given up. The authority can attain the goal of the administrative procedure also unilaterally, however, a private party does not agree with any evaluation of the rights or judicial interests imposed by the authority, it evaluates it critically and based upon its own considerations of justice. Moreover, it is not possible to use a universal pattern for the accurate definition of the correct resolution or act in changing life situations. Mediation provides the capacity for finding non-standard solutions within the framework of the legal norms, helps the personnel to evaluate the circumstances of the dispute in a better way when the mediator draws attention to the conclusions of the theory and case law, to identify the best resolutions to a dispute, their strengths and weaknesses, to develop the most realistic version of the solution, to achieve an agreement and to define the procedure of its fulfilment. Each party to the dispute has a possibility to analyse the circumstances and causes of the dispute in an active and responsible manner and to better understand the arguments of the other parties to the dispute. By allowing an active participation by a private party it assumes the responsibility for the final solution, thus there is a higher guarantee that the achieved resolution will be complied with and not appealed against by it.

Mediation and reconciliation can be used not only at the state of appeal and litigation, but also in the stage of the fulfilment of an administrative act or a court resolution.

The elements of mediation and reconciliation by means of which it is possible to achieve the agreement of parties to the administrative procedure as to a fair and judicial resolution efficiently should become a component of the administrative procedure because it offers a structure within which all the parties to the administrative procedure can actively participate in finding a resolution. The fundamental principles of the law are achieved in the use of the methods, i.e. the fairness, justice, transparency, participation, efficiency and informality.¹¹⁵ The use of the methods reduces the number

¹¹⁵ Haft F., Schlieffen K. Handbuch Mediation. München: Verlag C.H.Beck, 2009, p.215.

of cases when a private party applies to the court due to obvious lack of understanding and subjective reasons.

The use of mediation and reconciliation may be voluntary or mandatory. The mandatory use of the method can be provided for by a law or a court decision, and this is a deviation from the principle of the voluntary character. The mandatory mediation and reconciliation restricts the rights of a private party to a fair court, however there is a legitimate goal behind it, i.e. the resolution of disputes and the improvement of the efficiency of the court system, and the restriction is proportionate because it does not fully deny the access to the court and the parties do not have to agree on the conciliation on mandatory basis. The mandatory mediation and reconciliation can be imposed in the cases where usually a high number of participants is involved and it would be disproportionate and difficult to secure the agreement by all the parties on the use of methods, and in the cases where the efficiency of these methods is generally recognised.

The agreement on the use of mediation or reconciliation may be concluded in writing or verbally. It is done verbally if the number of parties is high and the conclusion of a written agreement would not be reasonable.

Mediation and reconciliation are accessible if the procedure of the remuneration of the mediator's services and other expenditure is fair and proportionate. In the administrative law deviations from the basic principle of the private law, according to which the costs related to the application of the methods are covered by the parties in equal parts, is admissible. If the law or the judge imposes mediation or reconciliation as mandatory or if an authority proposes to solve a dispute within the mediation or reconciliation procedure, as well as in the cases when it is used at the state of the issue of an administrative act, the expenditure related to mediation and reconciliation should be covered by the state. In the other cases the basic principle of the equal participation in covering the expenditure should be complied with. The total expenditure of mediation or reconciliation may not exceed the expenditure of litigation, therefore the state could define the professional fees of certified mediators and reconciliators and the procedure for assessing them similarly to those of notaries and intermediators in the criminal law. The participation of the ombudsman is free in any case.

In the public law mediation and reconciliation are aimed not just at the conclusion of reconciliation, the result may be also the repeal, amendment of an administrative act, the issue of an administrative act with a certain content, the recall of the application or admission as justified thereof. Both methods can eliminate the parties' doubts and lack of knowledge, as well as clarify the actual and legal circumstances.

In Latvia, the administrative procedure does not have the legal regulation for the use of mediation, however, this situation will change when the Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters is implemented. Different from Lithuania and Estonia, Latvia has not done it yet. The Directive is not applicable and it does not applied in the cases of revenues, customs or administrative cases, or in relation to responsibility of the state for the acts and inactivity in the course of implementing the state power, still the Member States are not prohibited to apply the provisions of the Directive also at the national level and to establish the generation regulation of mediation that would include also the terms of the use of mediation also in the public law. In Latvia the Mediation Law should cover all the branches of the law.

In the administrative procedure the duties of a mediator may be performed by a judge, a certified mediator, mediation commissions, the ombudsman, state and municipal officials. The perfect type of the judge comprises not only the judging, but also listening to the parties of a dispute, assistance to the parties of a dispute to achieve mutual communication and to resolve the dispute. The achievement of peace in the relationship between the parties to the dispute should be valued above the formal and narrow interpretation of duties. Besides, the Administrative Procedure Law has defined the impartiality law institute broader than it is in other procedure law. Within a single case, the judge may hear the case even if before that, when the application for temporary regulation was considered, he/she has expressed an opinion on the possible outcome of the case. The legislator has not admitted that this action creates the basis for doubting the judge's impartiality. Article 24¹ "Concluding a conciliation" which defines the judge's entitlement to lead the process of conciliation should be added to Chapter 3 "Basic principles of hearing cases" of the Law "On Judicial Power". In order to ensure that mediation becomes an integral component of the system of resolution of disagreements, the

authority of certified mediators specialised in resolving administrative disputes should be established. In Latvia, the Ombudsman's office should become the centre for the development of specialised mediators in the administrative law. State and municipal officials can both use mediation according to its traditional interpretation, when the dispute is between the addressee of an administrative act and a third party, and also its elements for encouraging the agreement with a private party. The state can also establish specialised mediation and reconciliation authorities that are a combination of the quasi court and the ombudsman from the point of view of their functions and role.

As it was referred to above, a reconciliation concluded by the parties to the administrative procedure may be a result of mediation and reconciliation; different from other alternative methods, this is not a procedure, but the resolution of a dispute in a form of a judicial transaction. From the point of view of the efficiency of judicial protection and dispute resolution, a conciliation has a higher value than a court judgement because it provides the best judicial protection to a private party according to his/ her judgement, and improves the judicial stability.

If an administrative act is a unilateral ordinance of an authority, a conciliation is an expression of the parties' to the procedure will justified by the agreement. The authority may not use the conciliation for refusing the performance of the duties imposed by the law, however, for the purpose of eliminating the dispute, the authority can use the conciliation for establishing the legal consequences that are different from the ones in relation to the initial administrative act, actual acts or the public law agreement if this does not breach the legal norms, is justified on the basis of reasonable considerations of usefulness and generally compliant with the public interests. Thus, by means of a conciliation the parties agree on the termination of legal relationship or its restoration and certain legal consequences are replaced with different consequences that cannot be disputed and doubted. The negative impact of the conciliation is that it prevents the parties from returning to their initial position. The positive impact is that the initial view is replaced with the regulation achieved in the result of the agreement. If a party does not duly perform the conciliation or doubts its validity, the other party cannot ask for the restoration of the legal consequences that have been terminated by the conciliation, however, he/she can request its performance by applying to the court. In the case of the conciliation the aspect of judicial protection is not that important, because a private party and an authority conclude only the agreements to which they fully agree.

The state administration works for the public interests that include also proportionate compliance with a private party's rights and judicial interests, therefore, in any case the authority has to evaluate the possibility and the usefulness of concluding a conciliation. The state administration and a private party do not have a general obligation to conclude a conciliation, however, if the private party has a total discretion to decide on concluding it, the principle of good governance and also the law stipulates the conditions for using the discretion of action of the authority.

In Latvia, the function of the conciliation is fulfilled by an administrative agreement which possesses another function. i.e. the provision of the quality of the administrative procedure. Although the empowerment provided in Articles 79-86 of the State Administration Structure Law allows an authority to conclude administrative agreements for the termination of a dispute without any additional authorisation by special laws, still, in practice it can be seen that these are more often concluded in the fields where special legal forms provide for the conclusion of the administrative agreement and the criteria of the agreement. For the purpose of improving the efficiency of the practical use of the administrative agreement institute, the legislator has to evaluate the possibility of including it also in other special laws, for example, the Building Law, the Law on Planning the Territorial Development, the Law on Municipalities, by defining also the criteria that should be evaluated when the decision on the conclusion of an administrative agreement is adopted.

The decisive precondition for concluding the administrative agreements provided for in Article 41 of the Law "On Taxes and Duties" and Article 27³ of the Competition Law is the agreement of the private party to the tax debt assessed by the State Revenue Service on unilateral basis or the breach established by the Competition Board. The administrative agreements provided for in both norms create beneficial consequences to the private party who voluntarily admits an administrative act issued within the unilateral dominance administration procedure. The narrow interpretation of the possibility of concluding an administrative agreement included in Paragraph 1 of Part One of Article 80 of the State Administration Structure Law as it is in both norms referred to above would be contrary to the goal and the principle of efficiency of the reconciliation institute. Thus, the State

Revenue Service and the Competition Board, as well as other state and municipal authorities can conclude an administrative agreement for the purpose of terminating a dispute also in other cases, for example, for finding a resolution compliant with the public interests and for preventing uncertainty when it cannot be done within a reasonable procedure, within the legal norms.

If the parties to the administrative procedure resolve a dispute and conclude an administrative agreement, the court resolution on the termination of the litigation, based upon the conclusion of the administrative agreement in the case is *res judicata* by character, therefore, the court supervision over the procedure of concluding the administrative agreement is essential in resolving on the termination of the litigation. In compliance with the current valid legal regulation the court just has to establish the fact of concluding the administrative agreement. Paragraph 7 of Article 282 of the Administrative Procedure Law should provide the obligation of the court to verify the judicial character of the administrative agreement, for example, whether the subject of the reconciliation is an issue covered by the competence of the relevant public person, whether the obligations of the public party are legal, whether the agreement does not contradict the principles of the state administration or does not impose disproportionate restrictions on the private party's judicial protection, and whether the agreement does not violate the rights and interests of third parties.

The State Administration Structure Law emphasises the conclusion of an administrative agreement within the court procedure which should be interpreted as inclusive of the stage of the execution of the court judgement as well. However, by respecting the principle of the legal certainty one should strive to conclude an administrative agreement as soon as possible following the emerging of a dispute.

Although an administrative agreement may be concluded at any stage of the administrative procedure, it does not always serve as the basis for terminating the litigation. Reconciliation serves as the basis for the termination of litigation if it has been concluded before completing the hearing of the case. An administrative agreement that is concluded at the stage of cassation would not serve as the basis for terminating the cassation litigation.

Prosecutor

Another method, i.e. the prosecutor, differs from the above referred methods because of its specific role within the administrative procedure. The prosecutor's functions are mainly related to the criminal procedure, however, the prosecutor performs certain tasks also in the administrative procedure. One cannot agree to the conclusion of the Constitutional Court that the prosecutor in the administrative procedure is just an element of the socialist law.¹¹⁶ In 39 out of 47 Member States of the Council of Europe the prosecutor performs tasks not only in the criminal procedure, but also in the administrative procedure. The legislator may oblige the prosecutor to perform tasks also outside the criminal procedure at its own discretion.

The prosecutor's role within the administrative procedure should be defined in compliance with the current judicial protection system. Taking into account that there are several methods for judicial protection and dispute resolution, and respecting that the criminal law is the basic field of operation of the prosecutor, the prosecutor's participation in the administrative procedure is an exception.

Under standard circumstances the prosecutor does not interfere in a dispute between an authority and a private party. The prosecutor interferes only in cases when it is necessary to defend essential public interests or where there are no other possibilities, but the principle of justice requires action. In exceptional cases also the protection of the interests of a particular private party may comply with the public interest, for example, the judicial protection of an incapacitated person, children, elderly persons.

When no public interests can be identified and other methods are available to a private party, the private party should use such methods. For the purpose of establishing a rational system of judicial protection and dispute resolution the prosecutor may not compete with the ombudsman or other

¹¹⁶ On the compliance of Part Two of Article 279 and Paragraph 4 of Part One of Article 280 the Code of Administrative Violations of Latvia in the section that stipulates that a court decision in the case regarding an official's decision on imposing an administrative penalty is final, and Part Four of Article 239 of the Civil Procedure Code of Latvia with Articles 89, 91 and 92 of the Constitution of the Republic of Latvia and Article 6 of the European Convention for the Protection of Human Rights and Fundamental Freedoms (4 November 1950): Judgement of the Constitutional Court of the Republic of Latvia (20 June 2002) in the case No. 2001-17-0106. *Latvijas Vēstnesis*, 26 June 2002, vol. 95.

methods for judicial protection and dispute resolution and implement the rights of private parties on their behalf. Within the administrative procedure the prosecutor defends the public rights and judicial interests and the ombudsman defends mainly the rights and judicial interests of private parties. Thus, for the purpose of protecting the public rights and interests the prosecutor should have the rights and obligations of the participant of the administrative procedure for defending the public interests. Paragraph 7 of Article 2 of the Public Prosecutor's Office Law, similarly to Part Three of Article 9 of the Environment Protection Law present exceptions provided for in Part Two of Article 31 of the Administrative Procedure Law according to which the prosecutor may apply to the court by protecting the public interests or the judicial interests.

Conclusion

All the above listed alternative methods are equal, therefore also other methods for judicial protection and dispute resolution have to be included in the clause of disputing of and appealing against an administrative act in Articles 76 and 188 of the Administrative Procedure Law in addition to the disputing and appealing accordingly. The wording of this indication may be general by emphasising just the possibility of judicial protection and dispute resolution by employing other methods. Specialised regulatory acts would detail the type of method and the procedure of their application.

Alternative methods are comprised within a uniform system and aimed at the attainment of a single goal, i.e. the provision of efficient judicial protection and dispute resolution within the administrative legal relationship. The state should have the law policy planning document that defines the goal of the system and the individual tasks of each method. Quantitative and qualitative result indices have to be set for the system of alternative methods and each method individually for making the evaluation of the attainment of the goal possible. Alternative methods have to be analysed collectively and within close context with the judicial system because there is an evident feedback relationship between them.

In comparison to other European countries, Latvia has not adopted essential regulatory acts for a long time, for example, the Mediation Law and the Arbitration Law; moreover, they should be adopted in such a way that ensures the application of mediation and arbitration also in the administrative procedure. However, the positive obligations of the state include not only the development of the legal regulation of alternative methods and the strategic planning of their use, but also the ensuring of the efficient application of the methods in the practice, in particular if the use of an alternative method is a precondition for submitting an application to the administrative court. The state administration has to establish the system of result indicators and summarise and analyse the operation of alternative methods on regular basis. For example, the mandatory appeal cannot be imposed arbitrary and it cannot be just illusionary, it has to be actual and efficient. The legitimate interests of private parties have to be balanced with the interests of efficient state administration, in the opposite case the private party's rights to the accessibility of the court are violated without a valid justification. In Latvia, the mandatory character is perceived as a dogma without any reason, besides the usefulness and efficiency of the mandatory appeal can be doubted because the state administration does not summarise and analyse the efficiency of the appeal on the level of individual authorities and the state as a whole on regular basis. For the purpose of evaluating the efficiency of appeal the state and municipal authorities do not perform and public the appeals statistics, analysis of changes on regular basis and do not provide the eventual causes behind it and the proposals for improving the situation, and the analysis of the appeal statistics and the causes behind the repeal of administrative acts.

The efficiency of judicial protection and dispute resolution presents a quality index that demonstrates whether the procedure defined and implemented by the state in practice secures the timely and compliant utilisation of rights and freedoms in a conflict situation between an authority and private parties and whether the justice and the goals set by the legislator are achieved within the procedure.

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A STUDY OF SHIPPING ACCIDENTS VALIDATES THE EFFECTIVENESS OF ISM-CODE

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Abstract:

The purpose of this paper is to examine human reliability with reference to all accidents involving Greek-flagged ships in restricted waters (ports, canals, straits, anchorages, coastal waters etc) through a 17-years time period (1995-2011). In this context, the effectiveness of enforced International Safety Management Code will be assessed.

The data analysis, using a Validation data set (upgrade data over the years from 2007 to 2011), revealed that the implementation of the ISM-Code led to an overall reduction of human-induced accidents in restricted waters.

Conclusively, the ISM-Code constitutes an effective policy measure for shipping safety. The results of the analysis reported in the present work can be used by decision makers in companies and international organizations to augment their information in the field of safety policy and management.

Key Words: Shipping safety, accidents in restricted waters, human error, ISM-Code

Introduction

The International Safety Management Code (ISM Code) was enforced by the International Maritime Organisation (IMO) in 1998, in order to provide an international standard for safe management and operation of ships and for prevention of pollution.

Accidents in shipping and marine environmental pollution are attributed to various factors. The UK Marine Accident Investigation Branch states that “*one factor still dominates the majority of maritime accidents: human error*” (MAIB, 2000). To this extent, a statistical analysis of shipping accidents attributed to “human error” in order to check if an increase or a decreasing pattern is observed through a 17-years time period. Thus, the ISM-Code impact and the effectiveness of its enforcement will be assessed.

A lot of researchers worldwide have been devoted in estimating dependency of shipping accidents from various factors (Celik, M., Lavasani, S.M., and Wang, J., 2010; Tzannatos, E., 2005).

Many researchers have used classical statistical analysis. Researchers (Giziakis et al., 1996) applied classical statistical analysis techniques in the records of vessel detentions and deficiency notices produced within the framework of inspections performed by the relevant authorities. These techniques produced a thorough shipping accidents analysis giving of human influence upon shipping accidents. Others researchers (Robert, S.E., Marlow, P.B. and Jaremin, B., 3012) have applied multi-factorial risk analyses revealing that the most important risk factors for ships foundering and for crew fatalities.

The study of shipping accidents using data mining techniques (Kokotos X.D and Linardatos, D.S., 2011; Kokotos, X.D and Smirlis, G.Y., 2005) may reveal additional information, for example, for the human influence upon accidents.

Researchers, within the human element domain, (Hetherington, C., Flin, R. and Mearns, K., 2006; O’Neil, W.A., 2003) provided analyses of the human element as a basic factor for accidents. Previous research in this area (Psaraftis et al., 1998) provided an ‘in-depth’ analysis of the human element as a factor in Greek shipping accidents during the 1984-1994.

A lot of effort from researchers worldwide has been devoted in assessing the effectiveness (Bhattacharya S, 2012; Knudsen OF and Hassler B, 2011; Tzannatos and Kokotos, 2009) of the measure of the enforcement of the ISM-Code.

The current work aims at estimating the dependency of the source of accidents due to human error upon the year of accident. The information will be used to assess the role of the ISM-Code, to measure the effectiveness of the enforcement of the ISM-Code and mainly to check if a decreasing pattern is observed through a 17-years time period.

Main Text

Data set description

The current work utilizes the information included in the official investigation reports of the Hellenic Coast Guard (HCG) referring to accidents of Greek-flagged ships in "restricted waters"¹¹⁷ over the years 1995-2011.

With respect to the choice of flag administration, it is assumed that Greek shipping, by virtue of its size and diversity, constitutes a valuable reference for the analysis of accidents

Prerequisites for the inclusion of an accident in HCG's official investigation reports are the situations that were encountered in the accident as: total (or partial) ship loss, permanent (or temporary) abandonment of ship by the crew, ship is taken-over by insurers, cargo loss, failure (more than 25%), prolonged loss of ship (command due to serious failure), loss of life (or serious injury to a crew member/passenger) or at least one of mentioned before them.

The variable *Source or Cause of accident* accepts values of "human error" (MAIB) or "non-human error". These values represent the conclusion of the reports based upon the formal investigation of the shipping accidents, with regard to whether a human entity (Ship's Master or 1st Engineer, Pilot, Offshore Personnel etc.) was ultimately responsible for the accident or otherwise (Random Event, Act of God, Unidentified Source).

For every year from 1995 to 2011, the accidents dataset includes the information depicted in Table 1. In this table, the percentages of human-error / total cases for each year and the 95% confidence intervals for each year are given.

YEAR	Human error / Total cases		
	lower	Percentages	upper
1995	50,80%	69,00%	82,70%
1996	43,60%	60,00%	74,40%
1997	51,50%	70,40%	84,10%
1998	39,10%	57,10%	73,50%
1999	33,50%	52,00%	70,00%
2000	29,00%	50,00%	71,00%
2001	30,70%	50,00%	69,30%
2002	49,70%	76,90%	91,80%
2003	23,30%	40,90%	61,30%
2004	24,50%	42,90%	63,50%
2005	38,80%	64,30%	83,70%
2006	26,80%	50,00%	73,20%
2007	25,50%	50,00%	74,50%
2008	16,93%	42,86%	68,78%
2009	21,71%	50,00%	78,29%
2010	16,03%	45,45%	74,88%
2011	9,64%	40,00%	70,36%
Total	51,10%	54,98%	62,90%

Table 1 Percentages of human-error / total cases¹¹⁸.

¹¹⁷ "Restricted waters" are defined as ports, canals, straits, anchorages, coastal waters etc (Kokotos, X.D., 2003, PhD Thesis, University of Piraeus, Piraeus) and represent the position of the vessel at the time of the accident.

For analysis, the variable *Year* have been grouped to check if an increase or a decreasing pattern is observed through a 17-years time period. In this respect, the variable Year from 1995 to 2011 grouped in three classes: "Test period A" (1995-1998), "Test period B" (1999-2006) and "Validation period C" (2007-2011).

The two classes "Test period A" and "Test period B" have been grouped in such a manner because the International Safety Management Code was enforced in 1998 by the International Maritime Organisation. Researchers in this area, (Tzannatos, E. and Kokotos, X.D., 2009) state that *"It is also early to assess the impact of ISM on the safety of the ships on which the Code has been implemented. This will take years to ascertain and the analysis to do so will not be trivial"*. In recognition of this statement, the period from 2007 to 2011, named "Validation period C", was added to the last two periods (from 1995 to 1998 and from 1999 to 2006) in order to validate the effectiveness of the ISM Code through a 17-years time period.

In table 2, the percentages of human-error / total cases for each class and the 95% confidence intervals for each class are given.

Period	Lower	Human error / Total cases Percentages	Upper
"Test period A"	55,23%	63,87%	72,50%
"Test period B"	43,65%	51,68%	59,70%
"Validation period C"	33,72%	46,03%	58,34%
Total	51,10%	54,98%	62,90%

Table 2 Percentages of human-error / total cases for class A, B, C.

Data analysis and discussion of results

In the Figure 1, was given Graphical presentation of the trends and the trend line of the percentages of human-error / total cases over the years from 1995 to 2011 with statistical 95% confidence limits for dataset depicted in Table 1.

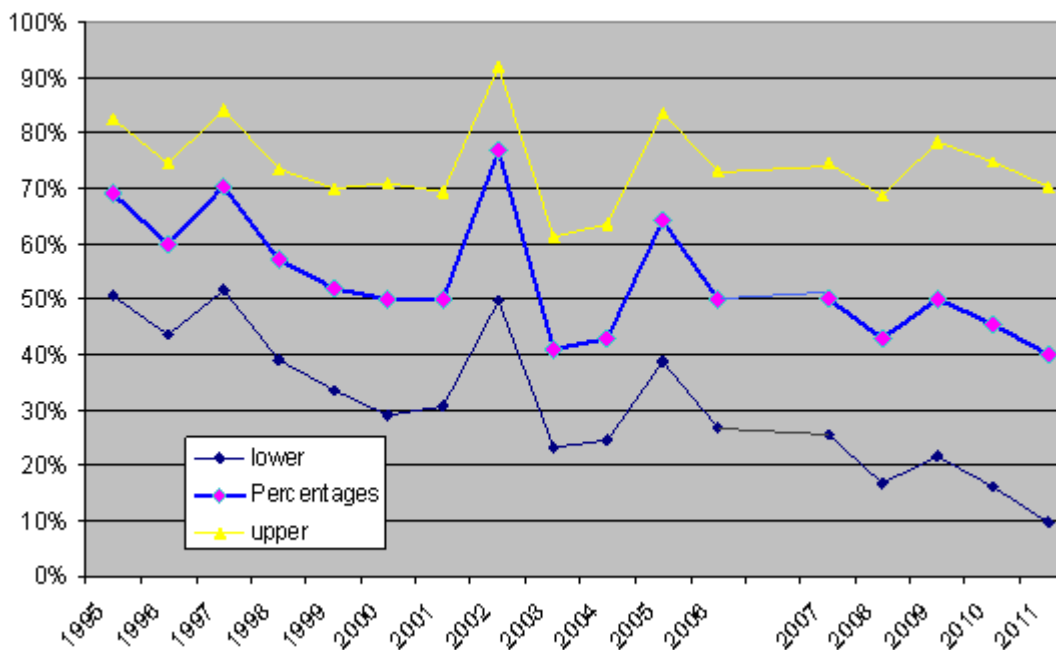


Figure 1 Trend line of the percentages of human-error/total cases (1995-2011).

¹¹⁸ All accidents involving vessels under 500 grt were discarded from the dataset because ships under 500 grt have been exempted of ISM-Code compliance.

According to the Graphical presentation in Figure 1, there is reduction in shipping accidents attributed to human error over the years from 1995 to 2011. More specifically, as depicted in Figure 1, the percentage of human errors/ Total cases seems to decrease by year.

The trend observed in Figure 1 was further explored using Chi-Square Tests in order to understand whether there is a statistically significant difference between (a) "Test period A" and "Test period B", (b) "Test period A" and "Test period C", and (c) "Test period B" and "Test period C" or no.

More specifically:

Hypothesis 1: Shipping accidents attributed to human error are decreased between "Test period A" and "Test period B".

In table 3, is given the Chi-Square Test output (Pearson Chi-Square = 4,012, df =1, p= 0,45). From Fisher's Exact Test (Exact Sig. 2-sided : 0,048), there is statistically significant difference between "Test period A" and "Test period B".

	Value	Df	Asymp.Sig.(2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	4,012(b)	1	,045		
Continuity Correction(a)	3,530	1	,060		
Likelihood Ratio	4,034	1	,045		
Fisher's Exact Test				,048	,030
Linear-by-Linear Association	3,997	1	,046		
N of Valid Cases	268				

a. Computed only for a 2x2 table

b. 0 cells (,0%) have expected count less than 5. The minimum expected count is 51,06.

Table 3 Chi-Square Test: "Test period A" and "Test period B"

Shipping accidents attributed to human error decreased between "Test period A" and "Test period B" because the ISM Code was enforced and consequently the policy of marine safety changed.

Hypothesis 2: Shipping accidents attributed to human error are decreased between "Test period A" and " Validation period C".

In table 4, is given the Chi-Square Test output (Pearson Chi-Square = 5,367, df =1, p= ,021). From Fisher's Exact Test (Exact Sig. 2-sided : ,027), there is statistically significant difference between "Test period A" and " Validation period C".

	Value	Df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	5,367(b)	1	,021		
Continuity Correction(a)	4,662	1	,031		
Likelihood Ratio	5,345	1	,021		
Fisher's Exact Test				,027	,016
Linear-by-Linear Association	5,338	1	,021		
N of Valid Cases	182				

a. Computed only for a 2x2 table

b. 0 cells (,0%) have expected count less than 5. The minimum expected count is 26,65.

Table 4 Chi-Square Test: "Test period A" and " Validation period C".

Shipping accidents attributed to human error are decreased between "Test period A" and "Validation period C" because the ISM Code was enforced and consequently the policy of marine safety changed.

Hypothesis 3: Shipping accidents attributed to human error are decreased between "Test period B" and "Validation period C".

In table 5, is given the Chi-Square Test output (Pearson Chi-Square = ,565, df =1, p= ,452). From Fisher's Exact Test (Exact Sig. 2-sided : ,548), there is statistically significant difference between "Test period B" and "Validation period C".

	Value	df	Asymp.Sig. (2-sided)	ExactSig. (2-sided)	Exact Sig. (1-sided)
Pearson Chi-Square	,565(b)	1	,452		
Continuity Correction(a)	,361	1	,548		
Likelihood Ratio	,565	1	,452		
Fisher's Exact Test				,548	,274
Linear-by-Linear Association	,562	1	,453		
N of Valid Cases	212				

a Computed only for a 2x2 table

b 0 cells (,0%) have expected count less than 5. The minimum expected count is 31,50.

Table 5 Chi-Square Test: "Test period B" and "Validation period C"

Shipping accidents attributed to human error are decreased between "Test period B" and "Validation period C" because the policy of marine safety changed.

Conclusion

The current work validated the ISM-Code impact. Shipping accidents, in restricted waters, attributed to human error were decreased between period 1995-1998 and 1999-2006 because the ISM Code was enforced in 1998 and the policy of marine safety was changed. Shipping accidents were decreased between period 1995-1998 and 2006-2011 because of the same reason. Also, shipping accidents attributed to human error are decreased between time period 1999-2006 and 2007-2011 because of the policy of marine safety was changed. Overall, there is a reduction in shipping accidents attributed to human error over the years from 1995 to 2011. Human error was found to be dependent on the year of shipping accident.

Human error was found to be dependent on the year of shipping accident in restricted waters. Shipping accidents attributed to human error were decreased between period 1995-1998 and 1999-2006 because the ISM Code was enforced in 1998 and the policy of marine safety was changed. Shipping accidents were decreased between period 1995-1998 and 2006-2011 because of the same reason. Also, shipping accidents attributed to human error are decreased between test period 1999-2006 and validation period 2007-2011. Overall, there is a reduction in shipping accidents attributed to human error over the years from 1995 to 2011. Thus the current work validated the ISM-Code impact.

The analysis of the Greek shipping accidents in restricted waters produced a validation of the ISM Code effectiveness. It was shown that the ISM Code constitutes an effective policy measure for shipping safety. It is indicated that the ISM-Code constitutes an effective policy measure for shipping safety, particularly for human safety. Although the ISM-Code implementation led to significant reduction of human-induced accidents, additional reduction is necessary. Further studies in this field will led to the adoption of additional regulations for the shipping safety.

The results of the analysis reported in the present work can be used by decision makers in companies and international organizations to build knowledge-based expert systems and augment their information in the field of safety policy and management.

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NEW PSYCHOSOCIAL RISKS HUMAN RESOURCES EXECUTIVES FACE WITH: PSYCHOLOGICAL AGREEMENTS, AGEING WORKFORCE, INSTABILITY BETWEEN WORK – PRIVATE LIFE AND MOBBING

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Abstract:

Important changes that has recently taken place in working-occupational-professional life has led to new risk factors to emerge in the realm of occupational safety and health. These factors which remain outside physical, biological and chemical risks and has adverse effects on occupational health and safety are termed psychosocial risk factors. Psychosocial risks are identified as social and organizational adversary activities which emerge due to the methods applied and arranged in relation to work life that give rise to psychological and physical harms.

The main aim of this study is to identify the new psychosocial risks that may influence the working lives of the individuals that take part in the social, economic, cultural and particularly technological changes and state which precautions the human resources units have to take under such menace. The subjects of psychological agreements, ageing workforce, work – private life conflicts, psychological harrassment at work place and mobbing are the four prominent psychosocial risk components that are dealt with in this context. Hence the precautions that the human resources executive has to take is discussed to reduce the components of the risks to a minimum.

Keyn Words: Psychosocial Risk, Psychological Agreement, Aging Workforce, Work-Private Life Conflicts, Mobbing

Introduction

Rapid changes in information technologies also brings new ways of working in work life. New working styles such as part time working, home offices, flexitime working have gained importance in our work. Staff members who are compelled to work in the intensive work medium along new styles of working, together with ever rising intensity of work pressure, are compelled to confront newer psychosocial risks. In order to enhance the level of productivity, businesses have to give the necessary appreciation that the human resources require. Undoubtedly, it is possible for a business to compensate for the financial loss within its structure. Yet, the compensation of the loss of the intellectual capital that may occur is a far more arduous process. In terms of a business the most important element among the production factors which needs to be administered effectively and successfully is human capital.

Besides getting the highest efficiency from the employees, motivation and maintenance of the human capital that organizations hold is also an important issue. The basic function of modern human resources management is to search for an answer to how to manage the human resources in an efficient way to reach the strategic targets of the organization.

To actualize this function what has been done, what can be done and what has to be done in the working place of the workers to make them happier and more productive must be determined (Bingöl, 2006: 5). Within this scope, the human resources manager is assigned the duty of enhancing the quality of the working life. This depends on the quality of working life, improving the working medium and reducing the risk factors that the workers encounter to a minimum. According to the results of a research realized in the European Union member countries, stress that arises from work is assessed as the most obtrusive illness among the workers, which influences over 40 million

individuals. In this very report, it has been indicated that during the last 12 months 6% of the workers have confronted with physical threat, 4% has been subject to violence , 5% has been harrassed or bullied. (Leka and Cox, 2008: 1). Another terminology which is used for systematic bullying and harrassment, yet which does not include physical violence aspects, is mobbing. In researches made in Turkey, it is emphasized that those who work particularly in service sector incur mobbing at a rate which ranges between 25 to 90 % (Gül, 2009: 517). These risks and the similar ones that workers encounter cause the quality of working life to reduce and effect work satisfaction negatively. This situation naturally generates unfavourable effects on work performance.

Substantial changes that takes place in working life in recent years have lead to new risk factors to emerge in the field of occupational health and safety. These factors that remain out of physical, biological and chemical risks and that act upon health and safety at work negatively are specified as psychosocial risk factors (Brun and Milczarek, 2007: 4). Problems concerning the organizational structure, factors causing stress in work place and the problems workers may have while coping with work can be identified as determinants of the psychosocial risk factors (IAPA, 2007). Psychosocial risk factors are defined as influences that may effect the performance of the worker negatively and psychological reactions that they develop towards the work place conditions (including their relationship with the managers and co-workers) (HSE, 2010). According to another definition psychosocial risk factors are identified as factors that effect the psychological reactions that the worker develops against work and working conditions and causing potential psychological health problems (Samra et al.,2009). Leka and Cox, on the other hand, identify pyschosocial risks as social and organizational problems that will give rise to potential psychological and physical injuries that emerges by the administration and arrangements of the management related to working life (Leka and Cox, 2008: 1).

Table 1: Psychosocial Risk Factors Related to Working Life

Content of Work	Absence of diversification of the work , fragmented or meaningless work, assign under use of skills and utmost discontent.
Work Load	Work overload or underload, machine pacing work, high levels of time pressure.
Work Schedules	Shift working, night shifts, inflexible office hours, unpredictable working hours, long working hours.
Control	Low Participation in decision making, lack of control on work load.
Work medium and equipment used	Inadequate equipment availability, suitability and shortage of maintenance, poor environmental conditions (lack of space, poor lighting,excessive noise).
Organizational Culture	Poor Communication, low levels of support for problem solving and individual improvement, lack of definition of organizational goals and acceptance by the workers.
Interpersonal Relations at Work	Social and physical isolation, having poor relations with employer and co-workers, inter-personal conflict, lack of social support.
Organizational role definitions	Role ambiguity, role conflict and responsibilities.
Career development	Unable to get promotion and obscurity, low wages, job insecurity, low social values attributed for the job.
Work – Home Interface	Conflicting demands of work and home, low support of family, problems concerning work and private life

Factors that effect working environment is identified under 10 categories by The World Health Organization (Leka and Cox, 2008: 2). The risk factors related to working life that take place in Table 1 are respectively work content, work load, work schedules, control, work medium and equipment used, organizational culture, interpersonal relations at work, organizational role definitions, career development, and work – private life inteface.

The main aim of this study is to define the new psychosocial risks that may affect the working life of individuals in the realm of social, economic, cultural, and particularly technological changes and to identify precautions the human resources units have to take in view of these threats. In this context, psychological agreements, are handled within four conspicuous psychosocial risk details namely the subjects of aging workforce, work – private life instability, harrasment and mobbing at work place. Following this, the precautions the human resources manager has to take to reduce the risk factors to a minimum is discussed.

Innovations In Work Contracts and Psychological Agreement

It is asserted by various researches that in our day the contracts workers sign when commencing work are no more efficient in showing dedication to the organization, displaying decent citizenship, having high performance and enjoying job satisfaction (Robinson and Morrison, 1995; Kickul and Lester, 2001; Coyle-Shapiro, 2002). Herein, the concept of psychological agreement which takes place outside job contracts and strengthens the communication between the organization (manager) and the worker is gradually gaining more and more importance.

In a broader sense, it is possible to define psychological agreement as individual reliance system designed by the organization about the conditions of a relationship of correspondence between the worker and the organization (Rousseau, 1989: 123). One component of psychological agreement which constitutes the employer's anticipation of skilled workers' commitment, honesty, ability to abide by work rules and achievement of high quality labour; while the other component constitutes how workers are evaluated at work and whether the opportunity to develop his/her knowledge, skills and responsibilities is given to form agreeable working relationship concerning psychological expectations. These expectations, while constituting the foundation of the psychological agreement between the worker and the organization, the fear that the person is not able to fulfill the expectations or that the promises given is not fulfilled cause disappointment, and thus the illusionary covenant in the mind of the worker breaks up (Cihangiroğlu ve Şahin, 2010: 2-3).

Different definitions of psychological agreement concept are seen in the literature. Levinson et al., (1962, 22), defines the concept of psychological agreement as the expectations of arrangement of relationship between the worker and the organization related to silent, implicit, and mutual responsibilities. In reference to Kotter (1973:92) psychological agreement is an agreement which has a psychological aspect that the parts expect to give to and receive from each other within business relationship that is not verbalized and implicit. As for Rousseau (1989:124) this concept expresses the individual's conviction about the nonverbal condition and situations between personnel and employer. Within the framework of these definitions the concept of psychological agreement is made up of understanding related to responsibilities and expectations based on individual beliefs within reciprocal relations. Rousseau (2004: 126) also reveals that there are the promises made within the structure of psychological agreement. Therefore, the promises given to workers and vice versa contributes to the occurrence of psychological agreement.

Psychological agreement concept moved into the interest of social scientist after 1960s, beginning to be examined in the literature of management and frequently finding place in the fields of organizational behaviour, human resources management and organizational psychology after 1980s. Theoretical origins of psychological agreement are based on the studies of Argyris and Levinson and friends, the "norm of reciprocity" of Gouldner and the "exchange and power in social life theory" of Blau (Özgen, 2010:747). Psychological agreements are on *formal* (relational, operative), *contextual* (perceived responsibilities or sort of transformation) and *infringement* levels (Millward and Brewerton, 1999: 254).

The sustainability of the existance of organizations and the ability to achieve the targets is realized by the act of individuals inside the organization in accordance with the targets in question. The primary requirement necessary for the workers to behave conveniently towards the aims of the organization is to provide the attitude for them to reach their aim themselves. This situation reveals the necessity of the effective functioning of the psychological agreements inside the organization (Rousseau, 2004:120).

The effective functioning of the psychological agreements inside the organization has significance with regard to both the workers and the employers. The worker who is convinced that his/her psychological agreement is running effectively simply perceives that he/she will receive the

reward for his efforts and thus reach his/her individual aims. The employer, on the other hand, is enabling the motivation of the worker by fulfilling his/her obligations, this situation deduces the feeling in the employer that he/she may acquire effective and productive results. Thereby, the parties act according to the expected behaviour and thus derive mutual trust.

However, in case one of the parties is unable to meet the obligations against the other, this trust diminishes, and apprehension that the psychological agreement is violated is revealed. The particular situation creates negative outcomes both for the organization and the workers. Robinson and Rousseau (1994: 247), reveals that the breach of psychological agreement is detected under conditions where the promises given by the organization to the workers are not kept.

As for Tükeltürk et al., (2010: 521) breach of psychological agreement or the factors that causes the agreement perceived as a breach are lined as follows:

- Conflict in the relation between workers and employers and low level of confidence,
- A presence of a social gap whereby parties do not understand each other's point of view,
- Insufficient efforts aimed at the sustainance of the psychological agreement,
- Excessive negative efforts directed to the breach of the contract,
- Importance and esteem given to the relationship between the parties only by one party,
- Flimsy and superficial communication between the parties,
- Unable to materialize the training of the workers despite the promises given,
- Adverse difference between promises given on the issues of wage-profit-other gainings and the ones which are materialized,
- Unable to materialize the promises given about promotion.

Kickul and Lester indicate that in case of confronting with an unjust situation such as the violation of psychological agreement individuals will show variations in their behaviour and reactions. According to these writes violation of psychological agreement causes negative behaviour with the workers, decreases their work satisfaction and clears off the worker's desire to display organizational citizenship behaviour. Robinson and Rousseau (1994) researched the results of the violation of psychological agreement on workers. In view of these writers, violation of the psychological agreement lessens the confidence of the worker for the employer, causes the satisfaction level related to both his/her work and the institution he/she is working for to reduce, effects the relationship with his/ her employer (manager) negatively, lessens the desire to continue working with the particular manager, and increases the wish to leave the organization he/she is working for.

The employers' effort to evoke the impression that the workers are valuable, encourage them to contribute in decision making, to create an explicit communicational environment, to build up a relationship held in trust, and to be able to meet their anticipations will resolve the perception of the worker that psychological agreement is violated. It is possible to say that the workers who think that psychological agreement is not violated, and the promises given have been kept, and whose expectations are materialized will take satisfaction from the work that they do and their commitment to the organization will enhance.

Aging Workforce

It is observed that number of scientific studies analyzing the connection between work life and aging have recently increased day by day. This can be due to the changes that take place in the structure of workforce in developed countries (Zwart et al., 1995: 1). It is stated that as an outcome of the researches the workforce in Europe and America is gradually aging and this will cause huge problems to arise in both the businesses and the economy of the countries (Remery et al., 2003; Haight and Belwal, 2006; Popkin et al., 2008; Silverstein 2008). What is more, according to Buyens et al(2009: 102), in the coming years governments, establishments and organizations of the whole world will be in an great endeavour to develop new strategies to cope with the problem of aging of the workforce.

Buyens et al.,(2009: 103), specify the causes of aging workforce that exists in the world as : the ongoing social securities systems, prolongation of human life as a consequence of nutritional food consumption and hygienic habits, the late entrance of workers to labor market as a result of longer training. Similarly, Griffiths (2000: 473) points to the continuous prolongation of human life as the cause of aging workforce.

Demographical changes that take place in a country emerged by the lessening of fertility rate and prolongation of the average life span results in changes in many economic and social fields such as economic growth, employment, productivity of workforce, personal savings, tax load and life standarts. When the complications that arise as a consequence of aging problem is examined from the viewpoint of working life, the most important problem appears to be related to the workforce capacity. Aging of the population, while increasing the number of the old workers within the total workforce supply, decreases the number of the young ones, which brings out the aging of the workforce, as an outcome (Gündogan, 2001:99; Akın, 2009: 30). From the economic point of view, support of the old population increases the economic costs to the society, effecting the employment and labour markets significantly by changing the demographic structure of labour (Gundogan, 2001: 99). Accordingly, aging of population, on the one hand causes the workforce capacity and the personal savings within the total GNP(Gross National Product) to decrease, on the other hand by increasing financial concerns sustainability of public expenditures arouse public problems. Also, owing to aging matters, as the aging dependency rate will increase the tax load will rise on the new generation (Akın, 2009:32).

When the studies and researches actualized concerning the issue are examined, it is seen that no precise concensus is reached on which upper age limit makes up the aging workforce. According to the definition issued by OECD, those who are in the second half of their working lives but who have not reached the age of retirement are within the scope of aging workforce. In reference to the definition of the German Labour Researches Institute, workers between 45 and 55 constitute the aging workforce (Brun and Milczarek, 2007: 68). Haight and Belwal (2006: 22), different from all those definitions, includes all workers who are 55 or over in the aging workforce. As for De Zwart et al (1995: 1) workers between the ages 45 and 64 are under consideration of aging workforce. In some other studies all workers at the age of 50 and over are evaluated within the aging workforce (Koopman-Boyden and MacDonald, 2003: 29, Remery et al., 2003 26; Loretto and White, 2006: 341).

Getting older causes various changes in the human structure. As a result of aging, cultural, behavioral, physical and psychological changes may be observed (Griffiths, 2000: 474; Silverstein, 2008: 271; Perry, 2010: 22). It can be said that along with getting older a fall at the conceptual skills occurs. The result of a research made on 6000 people aged between 25 – 88 assert that there is a fall of perception speed, word memorization and numerical abilities of individuals over 50 years of age with compare to others (Koopman – Boyden and MacDonald, 2003: 31-32).

Table 2: Changes In Ability and Functions Related to Old Age

Developing Functions and Skills	Reducing Functions and Skills
Experience	Muscle strength
Reliance	Senses of Seeing, Hearing and Touching
Ability of Judgement	Short Term Memory
Consistency	Speed of Perception
Awareness of Responsibility	Ability of Quick Response

Source: Emmanuelle Brun ve Malgorzata Milczarek, European Risk Observation Report 5: Expert Forecast on Emerging Psychosocial Risks Related to Occupational Safety and Health, Belgium, European Agency for Safety and Health, 2007, s. 69.

From the perspective of working life it can be observed that various positive and negative aspects of aging workforce exist. From this point of view getting old is assessed as a dynamic process that causes some of the functions and abilities of the worker to reduce as oppose to some of his/her functions and abilities to develop. Reducing and developing functions and abilities as a result of aging is shown in Table 2.

The leading negative result that aging workforce may cause for the organizational life is the fall of performance as a result of aging. Lessening of physical abilities, weakening in senses and perception may engender the performance of the worker related to his/her work (Haight and Belwal, 2006: 23). However, according to Koopman-Boyden and MacDonald (2003: 33) along with aging, knowledge and experience about the work implemented increases, which does not causing any reduction of the overall performance. Silverstein (2008: 271) affirm that although aging gives rise to lessening of physical and mental functions of the worker, this does not mean that the capacity of the

worker always falls or does not imply that productivity and performance of the worker drops. So the correlation between aging and work performance, the quality of the work implemented becomes important.

It is obvious that by the increase of old employees in the life of the organization various changes will occur and this situation will create organizational consequences. The organizational outcomes of aging workforce is shown in Table 3.

Table 3: The Organizational Outcomes Of Aging Workforce

Negative Results	Positive Results
Increase in Workforce Costs	Increase in Know-how and experince
Resistance to change	Decrease in organizational conflicts
Increase in absenteesim	Increase in productivity
Downward will towards new technologies	
Negative effect on organizational image	

Source: Chantal Remery ve diğerleri, "Managing An Aging Workforce and A Tight Labor Market: Views Held by Dutch Employers", Population Research and Policy Review, Vol. 22, No: 1, 2003, s.29.

From organizational point of view it is observed that aging workforce has positive and negative consequences, therefore, this process is required to be managed well. Brun and Milczarek (2007: 72), mentions the concept of age managing and argues the necessity of age management to be applied by the general management. The losses that occur as a result of aging workforce, may disappear when coalesced by policies and applications realized by the public relations department of the businesses. In view of Koopman-Boyden and MacDonald (2003: 35) implementations concerning age that are not integrated with the policies of human resources have little likelihood of success.

The necessity of change in the structure of the organization also rises with aging that appears in workforce. Remery et al. (2003: 32) assert that this situation may vary according to the magnitude of the organization. That is to say, in big organizations the requirement to structural change is increasing in concurrence with aging. Comperatively, not much requirement is felt in respectively smaller organizations.

The applications that has to be executed by businesses concerning the management of the aging workforce may be ordered as follows (Brun and Milczarek, 2007: 73):

- Maintaining work design and protective occupational health services which will enable the workers to stay at work until retirement,
- Drawing ergonomic design of the working environment,
- Reducing time pressure on workers,
- Introducing flexitime working patterns,
- Placing emphasis on continuous updating of applications of life-long learning based on knowledge,
- Forming teams made up of young and old to perpetuate the continuity of knowledge and experience of older workers who are more knowledgeable and experienced

Disregarded and undirected aging workforce may cause a disadvantage with regards to businesses. Consequently, it is imperative to consider the applications concerning the aging workforce in human resources policies developed by establishments for the substantial administration of the process.

Work-Private Life Conflict

Work and family are positioned as the most important aspects in the lives of individuals (Frone et al, 1992:65). However, in our days, working life occupies a large part of an individual's daily life thus influencing his/her life style and thoughts concerning the future. As a result, by and large, the individual heed more on the roles that his/her working life imposes on him/her. Still, individuals have various other roles in their family lives, as is in work. To be able to attain the sense of peace and satisfaction, the roles in both sides have to be managed in the best possible way. Otherwise, there will be an imbalance between the individual's work and private life and the individual will undergo concerns both in his/her work and private life (Oflluoglu et al., 2009: 165).

The concept of work-private life inequality began to be researched after 1980s; a lot of studies made throughout those years suggest that family life has a lot of effects on working life and working life has a lot of effects on family life (Netemeyer et al., 1996: 400). In these studies it is attempted to emphasize the sort of adverse effects of conflicts that occur between work and private life and the kind of adverse effects there are in working life (Greenhaus and Beutell, 1985; Frone et al., 1992; Carikci, 2001; Pasewark and Viator, 2006).

When the literature is studied it is seen that the conflicting conditions between the individual's working and private life is examined within the framework of the concept of "disagreement between work and family life". As for the main reason of the conflict that occurs between work and family life, an existing disagreement between roles of the individual towards his/her work and family can be indicated. Accordingly, work – family life conflict is determined via the result of an inconsistency between the role internalized as a requirement of being a member of an organization and the role internalized as being a member of the family (Efeoglu and Ozgen, 2007: 238). This is because the roles related to both work and family are prime roles that the individual undertakes, and the responsibilities assumed concerning these roles keep the whole life of the person under control (Ozdevelioglu and Aktas, 2007: 5).

Work – family conflict can generally be identified as an inter-role conflict in which the role demands stemming from one domain (work or family) are incompatible with role demands stemming from another domain (family or work) (Greenhaus and Beutell, 1985: 77).

Similarly, according to Carlson et al., (2000: 249) work-family life conflict is the state that causes a role conflict as a result of some incompatibilities between work – family life pressure that the person feels for his/her roles stemming from role clashings.

Concerning work and life process analysis, the reasons that effect the stemming of the conflict depends on the characteristics of the person with himself/herself, with his/her family and with his/her work. Hence, the factors that cause work – family life conflict are analysed in three groups (Çarıkçı, 2001: 4-5; Pasewark and Viator, 2006: 148-149; Ofluoğlu et al, 2009: 166-168).

- Personal Characteristics: gender, personality, age
- Characteristics concerning work life: long and irregular working hours, overtime, low wage, negative attitude of the top management, stringent working schedules
- Characteristics concerning family life: commitment to family life, excessive time spent outside work, shortage of family support, interfamily conflicts, excessive number of children

How work-family conflict may occur and under which forms it may arise is researched in a variety of ways. When the literature is examined it is seen that there are three types of work – family conflict. These are **time-based** work-family conflict, **strain-based** work-family conflict and **behavior-based** work-family conflict (Greenhaus and Beutell, 1985: 77-81; Netemeyer et al., 1996: 401; Carlson et al., 2000: 250).

It is apparent that all kinds of conflict and negative situation that take place related to work and family life will create bad effects. These kind of conflicts will effect both the working life and the family life of the individual adversely. Besides, work-family conflicts may also cause adverse effects on the individual's physical and psychological health. Mullen et al., (2008: 199), range the adversaries of work-family conflicts that develop on individual's physical and psychological health as excessive stress, general psychological strain, alcoholism, bodily and psychological breakdown, exhaustion and depression, increase in drug use. Another research performed on the effects of work-family conflict on the physical health of the individual is achieved by Frone et al., (1997). For the results of this research, work-family conflict influences the physical health of an individual negatively, arousing increase in blood pressure, hypertension and inciting depression. Nevertheless, according to the research results, a positive connection is established between work-family conflict and excessive alcohol consumption.

A lot of consequences may also arise from the perspective of the organizations that the individual is included, with concern to the conflicts that will arise between work and family life. Carlson et al., (2000: 268) state that work-family conflict will give rise to fall in job satisfaction and organizational commitment, fall in quality of life, thus causing decline of life satisfaction and cause employee takeover rate to increase. In a similar manner the study conducted by Netemeyer et al., (1996) asserts that work-family life conflict decreases

work satisfaction and organizational commitment, and work and private life satisfaction, as well as lessening the happiness in relationships, as oppose to increasing the individual's sufferance from role-conflict, ambiguity of role and intention of withdrawal from work.

The consequences that work-family conflict may arise from the perspective of individuals and organizations, can be summarized as decrease in life satisfaction, fall in organizational commitment, reduction of career satisfaction and commitment, increase in desire to withdraw from employment, lessening interest in work and family, an increase in work stress and work satisfaction, taking no responsibility at work, increase in stress and exhaustion, fall in performance (Ofluoglu et al., 2009: 170).

When the consequences of work-family conflict are analysed, it becomes clear that various negative effects engender from the perspective of both the individual himself, and the individual's family as well as from the perspective of the organization which the person is included. So, it may be argued that work-family conflict effects the whole life of an individual, as well as causing the individual's life quality to drop (Ofluoglu et al., 2009: 170).

It will not be wrong to say that work-family life conflict effects the personal happiness and life satisfaction of the workers directly. Besides, this kind of conflicts, have direct effect on work stress, job satisfaction and organizational commitment from the perspective of the organization the individual is positioned. Generating feasible human resources policies, materializing organizational arrangements and applications is significant in order to conduct work-family life conflict effectively. Thus, it is important to determine at what direction and degree the manner and behaviour concerning their work is affected by the level of work-family life conflict of the workers who work in businesses operating in different institutional environments and markets.

Mobbing (Psychological Harassment At Work)

The word 'mobbing' is derived from the Latin word "mobile vulgus" which means: mass of people with tendency towards violence; unstable crowd. The word which stems from "mob" in English, meaning crowd with tendency towards excessive violence, implies forming an activity at workplace against someone, making emotional attacks or psychological bullying (Leymann, 2010).

The word 'mobbing' was first used in 1960s by Australian scientist Konrad Lorenz, who was analysing animal behavior. Lorenz used the term mobbing to identify the behavior of the animals that they performed to frighten away an outsider or an enemy hunting. Afterwards, Doctor Heinemann who was analysing the relationships of the children outside school, used the term mobbing to define frightful behaviour of the children towards a lonely child (Leymann, 1996: 167).

The concept of mobbing began to be used to identify the offensive behaviours between the individuals in workplaces following the 1980s. The first person who used the concept in order to analyse the relations between employees in work life became Heinz Leymann. Leymann used the term mobbing to define the behaviour of constrain, violence and intimidation in work life. According to Leymann, psychological terror or mobbing involves continuous hostile or unethical behaviour of one or more individuals in work life to put a co-worker into helpless and vulnerable position (Leymann, 1996: 167 – 168).

Mobbing stands as one of the excessive forms of source of social stresses in work life. Apart from other sources of social stresses, mobbing emerges in the form of long term, violent strife (conflict) condition that aims a particular individual and encompasses systematic harrassing behaviour (Zapf, 1999: 70; Einarsen, 2000: 380).

In our time, concept of mobbing is defined differently by various writers. Leymann (1996: 165) defines mobbing *as applications of systematically hostile and unethical behaviors and activities enforced by more than one person towards another person pushing the person into an unaided and vulnerable position*. As for Zapf (1999:70) mobbing means ostracising a person outside the social environment or humiliating someone by employing the person below his/her position in the workplace and assigning below the person's capacity by behaving abusively, tyrannously and aggressively in the workplace against the person. Einarsen (2000: 380), on the other hand, identifies the concept as all situations that encompass an employee, a supervisor or an administrator to incur systematic and continuous misdemeanor and to be exploited by a co-worker, a subortinate or an administrator.

Within the scope of these definitions mobbing is identified as psychological and even physical offensive behaviors that take place in a workplace, by one or more individuals, towards one or more persons, with a systematic, inimical, and unethical approach, which continues for long terms, for a

variety of reasons, aiming to intimidating the person, which is applied to break down the self confidence of the person.

Cusack (2000: 2118) indicate that there are three common aspects of the definitions related to the concept of mobbing. These are the effects of mobbing activity on the maltreated, regardless of the intention of the perpetrator of mobbing, the level of harm and the negative outcomes of these effects on the maltreated, and the continuity of the mobbing behaviour.

Mobbing and other similar behaviours have been known for a long time, however they are shunned to be revealed or they are disregarded. Especially, fear of the workers to lose their jobs or to be dismissed because of economic crises, create the outcome where these people have to consider mobbing as a means to endured mobbing. Due to this reason workers try to resist mobbing which turns into a torture. This situation, by encouraging the perpetrators of mobbing even more, turns the case almost into a paradox. As a consequence, the effects of mobbing becomes tougher and tougher (Paksoy, 2007: 10). Leymann points out that the individuals confronting mobbing often endure these assaults and they do not resign on short notice. The reasons for this, according to Leymann (1996: 174) are situations like the aging of the individuals or not having adequate skills to be able to find another job.

Mobbing, is a kind of psychological terror applied in the form of assaults repeated by other employees or employers and the process of mobbing commences by the person's incurring mobbing, as the target of a disrespectful and harmful behavior (Işık, 2007: 47). Leymann (2010) makes 45 different mobbing behavior definitions and collects these under five headings. These are; blocking the means of communication of the sufferer, preventing the sufferer from the possibility of accomplishing social relationships, acting derogatively to infringe the sufferer's reputation, acting to inhibit the professional life of the sufferer and committing acts that will influence the physical health of the sufferer negatively.

Physical, mental, and psycho-somatic health problems are the main problems commonly seen as a result of mobbing. As an example to these problems, stress, depression, declining self reliance, self accusation, developing fobia, sleep disorders, digestion and muscular system disorders can be listed (Işık, 2007: 58). Gül (2009:517), emphasizes that the effects of mobbing on health show up in three phases. In the first phase, crying frequently and without cause, sleep disorders, short temper, and difficulty in concentration are observed. In the second phase symptoms such as hipertension, stomach complains, depression, unwillingness to go to work, tardiness are added. As for the third phase, the intensity of depression increases, panic attack and state of anxiety develops. Also in the last phase accidents and tending to commit suicide can be seen. As for the other problems the individuals who are subject to mobbing will face outside health concerns are lined up as follows: work alienation, increase of discord with colleagues, decrease of productivity, decreasing dedication, diminishing life and work quality, concerns with social relationships, mistrust towards co-workers or administrators, intending to resign from work. (Einarsen, 2000: 387; Solmuş, 2005: 10; Paksoy, 2007: 45; Gül, 2009: 518).

The organization itself is effected as much as the individuals from mobbing activities that arise within the organization. Mobbing has an impact on the total organization from the beginning to the end, arising a lot of unspecified disturbances, impacts and complications (Gül, 2009: 518). As the result of mobbing activities, organizational working environment deteriorates, productivity and efficiency standards cannot be achieved (Gül, 2006: 70). Leymann (1996: 174), indicate that mobbing activities have negative effect on organizational structure and deteriorate the psychosocial workplace medium. The possible organizational outcomes of mobbing are sorted as increase in production costs, increase in employee turnover rates and impaired motivation.

Mobbing is considered to be one of the psychosocial risks that businesses and workers undergo. Whether they realize or not, a lot of individuals in working life are exposed to mobbing. Besides this, physical and mental health of an individual deteriorates, problems related to work life occurs and organizational life quality fails as a result of mobbing. Therefore, it may be asserted that the main activities to fight against mobbing is to provide all the workers and administrators within the organization to understand the importance of this matter and get them trained in this subject. Accordingly, manipulation of mobbing, one of the recent psychosocial risks we are confronted with, and methods of struggle against mobbing pose a significant importance both on the part of organizations and individuals.

Manipulation of Psychosocial Risk Factors

Preventing or minimizing psychosocial risk factors, is likely to depend on developing organizational policies aimed at preventing the risks, basically by convening businesses, labourer and employers union and state institutions together. Following this, the policies constituted must be converted to practices at the level of administration and must be developed systematically (Leka and Cox, 2008: 48).

When compared to physical risks, lessening psychosocial risks are rather related to the development of the medium of work and contribution (HSE, 2010). The necessary strategies for the businesses to be able to administer the psychosocial risk factors may be summed up like the following (IAPA, 2007);

- Encouraging the participation of workers in managerial decisions,
- Provision of justice in administrative applications and implementations of organizational policy,
- Providing a fair distribution of income in the organization,
- Training and developing managers on the subjects of communication and human relations,
- Providing flexitime work schedules,
- Putting the applications aimed at providing a balance between work and family life into effect and establishing the culture which supports this,
- Showing appreciation towards boosting work efforts of workers,
- Enabling all workers to respect to each other in the workplace environment,
- Work satisfaction of workers must be regularly evaluated and arrangements must be made pursuant to outcomes,
- Problems aggravating workload of workers must be determined and prevented.

The European Framework For Psychosocial Risk Management Report (PRIMA-EF) published by Leka and Cox (2008) aims at applications related to the management of psychosocial risk factors within the European Union both at national and organizational level. With reference to this report, five important activities must be respectively applied for the management of psychosocial risks. These are: to review identified workforce, working environment and activities implemented within the organization, to evaluate the risks in order to better understand better the nature of the concerns and the underlying reasons of the concerns that arise, to evaluate the activities applied and the effective and careful management of the process (Leka and Cox, 2008: 4).

Operational policies developed for the purpose of establishing the management of psychosocial risk factors convey a message to both the workers and the stakeholders implying that the enterprise stresses importance on these issues and implements significant applications to prevent them. All the phases of psychosocial risk management has to be organized and implemented by the participation of the major stakeholders and if appropriate by the backing of experts (Leka and Cox, 2008: 48).

Conclusion

Human resources is the most important factor that leads a corporation to success or failure. For the businesses to bring the most advanced technologies or to make investments that require serious costs does not mean that they will be successful. The success of a business may only be possible by retaining the human resource that acquires the skill of using these technologies. In order to be able to fight back against the new psychosocial risks that currently arise, job descriptions and targets concerning the performances of all workers have to be clearly assessed. As expectations from workers, hierarchical set up, inter-organizational interaction, responsibilities of the employees to one another and to the management are not identified well enough in a lot of establishments where ambiguities arise and misunderstandings of workers provoke tension and unrest. Inter-corporational link channels must be developed; the way to establish an effective and positive communication must be paved. Besides these, motivating workers by means of appreciating their success leads to a peaceful establishment of working environment.

From the workers' point of view, a concept of change is always frightening. In the present competitive environment, to follow the improvements closely and to be able to move on to the new direction has become indispensable for the establishments. The ability of establishments to adapt themselves to the new developments can be possible by the participation of the workers in the developments. Yet, workers can not get adapted to new developments in a lot of establishments. The

underlying reason is the resistance to change. To overcome this resistance workers have to be allowed to express their concerns, the areas which the workers find change difficult must be understood and they have to be granted respite to be convinced why change is necessary on the issues and of course they must be provided with an agreeable training period planned to adjust to the new changes.

Managers of businesses must be well-informed on the issues of organizational targets and policies and they must give importance to the expectations of the workers, and they must remove the obstacles for the workers to express themselves. The feedback obtained through communication with the workers has to be scrutinized effectively by the managers. As the concept of authoritarian concept of management diminishes in the world as well as in Turkey, management concepts in which the satisfaction level of workers become crucial gain importance. A successful manager has to make the arrangements thereafter which provide the satisfaction levels of the workers to rise. In case of organizational impact the circumstances have to be analysed thoroughly, the factors that lead to the organizational conflicts have to be assessed and the existing conditions have to be managed for the benefit of the establishment.

Currently, the success of establishments highly depends on workers. Therefore, it is crucial that workers get training that enables them to adopt organizational targets to gain organizational culture and to have effective communication skills. However, as in people's lives workplaces, working relationships and achievements in workplaces hold a crucial place, getting satisfaction from working place environment is becoming more and more important. For this reason very conscientious efforts are directed to the employee satisfaction in a lot of establishments.

Businesses are bound to develop new methods in the struggle with psychosocial risks which have negative impact on the effect of human capital in working life to maintain their organizational lives in an ever increasing competitive environment.

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SOCIAL POLICY - SOCIAL INTEGRATION OF IMMIGRANTS RESEARCH IN THE CITY OF RETHYMNO-CRETE

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Abstract:

The phenomenon of migration is of timeless, transnational and multidimensional nature and the extent of the economic, social and cultural causes of its creation and its effects make it extremely complex, especially in conditions of globalization.

The economic and geopolitical changes taking place in Europe and around the world over the last twenty years could not leave our country intact. Greece, a "sending" country, turned into a country of immigration after the 80's. In Crete, particularly in the city of Rethymno, a relatively increased influx of immigrants was observed, in comparison with other regions of the country, due to the employment opportunities for foreigners in the area.

Our aim is, through the relevant literature and the use of field research, to approach the phenomenon of migration and immigrants' social exclusion as well as the policies implemented for their social integration.

In the context of this thesis, research was conducted to investigate the social integration of immigrants who lived permanently or seasonally in Rethymno, which was a highly complex process. The survey was conducted by completing a structured questionnaire, and was implemented in December 2012.

As a research tool, we used a questionnaire with 31 questions on personal data about marital status, educational level, reasons why they left their homeland, as well as data related to training programs in our country, employment, social security, attitude of the Greek society and the society of Rethymno-Crete and the attitude of the city's public-government agencies towards them in order to satisfy their needs during their stay. The Questionnaires were completed in the Voluntary Welfare Clinic of Rethymno. Indeed, all immigrants participating in the research enjoyed the free services of the clinic. Overall, while we addressed about 30 migrants only 15 (8 men and 7 women) agreed to respond. Many of them refused to participate in the survey because they do not have official documents for their stay in Greece.

The results of this survey show that the majority of immigrants came in Rethymno in order to settle down and live here for a long time. The majority of immigrants evaluate as favorable the living conditions of them and their family in the new host country. Therefore, the relationship between immigrants and the state and public agencies, as well as the local community, seems to be very important for the process of their integration in Greek society.

Finally, they are absolutely satisfied with the services provided by the Voluntary Welfare Clinic of Rethymno. This result indicates the important role of the clinic in the attempt for the "smooth" (gradual) social integration of immigrants in the local community.

Key Words: Immigration, Social Integration, Social Policy, Social Exclusion, Public-Government Agencies, Volunteer Clinic of Rethymno-Crete, Municipality

Social Policy και Immigrants

The meaning of the term «social policy»-Organizations of social policy

"Social Policy" is the science, which has as field of investigation the protection system for the weaker social classes aiming at social development.¹¹⁹

The main objective of social policy is the promotion of the welfare and prosperity of the citizens of a country with a focus on ensuring a safe, healthy and quality life. The safety, health and quality of life are the core of the concept of welfare and prosperity. An important element of the study of social policy is the way the welfare and prosperity is provided through policies and actions.

One other essential aspect is the study of the National Health Systems, how the concept of Health is defined as well as the ways in which it is promoted like the education systems in the light of the social dimension of education. Also, at the heart of social policy, there is the study of the citizens' material needs, accommodation needs, transportation needs as well as environmental factors. The redistribution of resources is a central objective in relation to the material needs of people and with focus on the income, the resources and the social security.

The Social Policy is provided at the state level through governmental actions and the organization of state and public Welfare bodies, by private and for-profit organizations, community volunteer organizations aiming at social care for people in need and finally by the informal care networks for family and family formations which play an important role in its study and promotion.

A social policy entity is "the organization of people and resources under a unified administration for the realization of objective social policy goals"¹²⁰.

The social policy organizations are the following:

I. Public entities. The leading public body is the State which sets the ground rules for the exercise of social policy.

II. Private entities: The main private organizations are a) social protection institutions, b) charity associations, c) labour unions that support their members, d) consortiums, e) firms that grant benefits to their staff.

III. International bodies: the main ones are: a) the Economic and Social Council of the UN, b) the World Health organization, c) Food and Agriculture Organization, d) the International Labour Organisation.

IV. European bodies such as the Council of Europe which aim at a greater unity between its members through co-operation in order the economic and social progress¹²¹ to be facilitated.

Parameters on which the social integration of immigrants depends

The integration of immigrants is a complex process and "is related to several parameters concerning structural elements of both the sending and the host countries of immigrants and the individual features of these displaced persons. It is also linked to official immigration policies and integration strategies adopted and implemented by the host country in order to achieve the smooth function of society which is ensured by social cohesion"¹²². The main indicators of the social integration of immigrants are:

- **Their integration into the labor market of the host country** (employment). According to the European Commission "the integration into society is identified with the integration to work."¹²³ Employment 'is a crucial mechanism for the integration of immigrants, not only for economic but also for social reasons."¹²⁴ It is very important for the integration of immigrants, the nature of their employment to be associated with their qualifications and skills, the level of their income to be adjusted to the socio-economic background, the labor law to be enforced (social insurance, etc.). Moreover, the development of entrepreneurship and self-employment of immigrants create a climate of acceptance by the host society and ultimately their social inclusion.

¹¹⁹ Vlachadi M., (2010), Special Issues of immigration policy- Social policy for child protection in Greece και European Union, Athens: Herodotos, p.15

¹²⁰ Vlachadi M., (2010), Special issues of immigration policy,, p.19

¹²¹ Vlachadi M., (2010), Special issues of immigration policy,, p.20-21

¹²² Kasimati K. (2009), " The country of origin of female immigrants and their social integration in Greece", Journal «Social Cohesion και Development», volume 4th,issue 1, Spring 2009, p. 8

¹²³ Kasimati K. (2009) " The country of origin of female immigrants and their social integration in Greece", p. 9

¹²⁴ Vlachadi M. (2009), Immigration policy of the European Union, p. 104

- **Accommodation.** It is a significant indicator for the evaluation of the integration of immigrants into society and is related to the recognition or not of the legal rights of immigrants, the discrimination they experience in the rental housing market (eg refusal to rent), to the formation of ghettos etc.

- **The legal or not stay of immigrants in the country** is a very important factor for their social integration. The legal residence (legalization) of immigrants is a key mechanism for their integration in the labor market and then for their integration in the host society. "It is commonly accepted that legalization is the key mechanism for the integration of immigrants of all countries of the world. The status of illegal immigrant is the basic typical factor for the exercise and reproduction of any kind of inequality, even in cases where the ground for the development of inequalities is not appropriate"¹²⁵.

- **The cycle of their social relationships.** When immigrants socialize with people of the local communities, it means that the natives have overcome prejudices and stereotypes and they can coexist and live in peace with them.

- **The access of immigrants to the Greek services** is a crucial indicator that shows the degree of integration of immigrants into Greek society. Their access to the national health system, public education, child day care centers and other social services, as well as agencies such as the Employment Agency, the Police, the Ministry of Foreign Affairs, depends on their legal or not immigration and is an important aspect for their social inclusion.

- **The manifestation or not of racist practices on the part of the host society** is also a significant indicator which illustrates the degree of social integration. "In the host countries, the presence of foreigners, especially if they are large in number, negative stereotypes about them have been developed and in a part of the population the view that immigrants are a threat to social cohesion and in extreme cases the purity of the race, is dominant "¹²⁶. The existence of such perceptions is a hindrance to the integration of immigrants in host societies.

Results of research investigating the integration of foreign immigrants in the Municipality of Rethymno

In the context of this research, a survey was conducted for the investigation of the social integration of immigrants that reside permanently or seasonally in Rethymno. The survey was conducted by completing a structured questionnaire, and implemented in December 2012.

(The research questions were based mainly on the Research for the forms of social integration of economic immigrants in the Region of Attiki 2003-2004, the Institution of Employment of GSEE/ADEDY, http://www.immigrantwomen.gr/portal/index.php?option=com_content&view=article&id=38:-2003-2004&catid=3:2010-05-27-07-48-21&Itemid=13&lang=el)

The social integration of immigrants is linked by a series of parameters most significant of which are: the way of entry into the country (legal or not), the time spent in the country, their legal or not stay in the country, their integration into the job market, the cycle of their social interactions, their relationship with the Greek services (health, education, Police, Employment Agency, Ministry of Interior Affairs, etc.), the manifestation of racist practices on the part of the host society, etc.

The purpose of this research is to investigate the degree of social integration of immigrants living and working in Rethymno, according to the above-mentioned parameters.

The majority of male and female immigrants in our sample were men and women of productive age, men were seasonal workers, mainly in construction, farming and rural tourism businesses, and the women were working as au pairs (elderly care) and seasonally in tourism businesses.

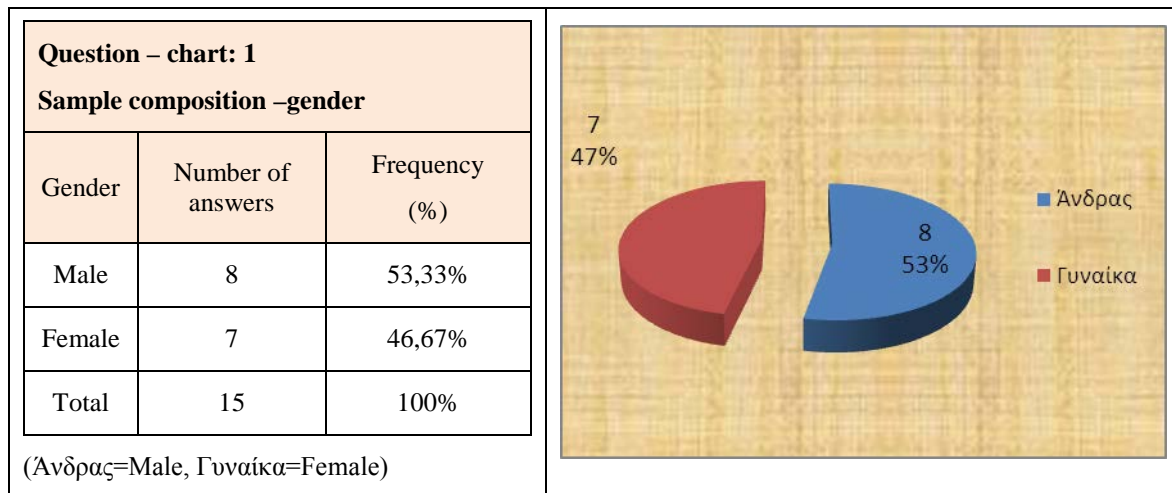
At this point, it should be noted that the sample cannot be regarded as representative, firstly because of the small number of participants, and secondly because the selection of participants was not made on a scientific basis. Nevertheless, some important conclusions are drawn that can be considered representative for both the degree of social exclusion of immigrants and their social inclusion, as well as how the immigrants themselves see their position in society of Rethymno.

¹²⁵ Papadopoulou D, (2009) The effect of legal residence in the social integration of immigrants in Greece, Journal «Social Cohesion και Development», volume 4th, issue 1, Spring 2009, p. 46-47.

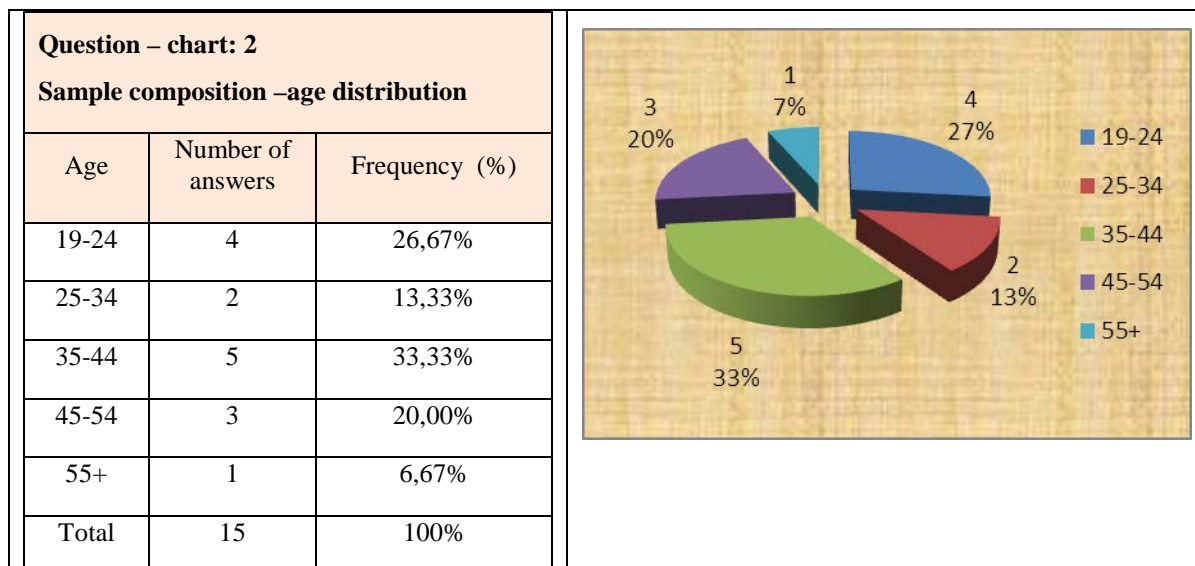
¹²⁶ Kasimati K., (2009), " The country of origin of female immigrants and their social integration in Greece", p.22

The Questionnaires were completed in the premises of Voluntary Welfare Clinic in Rethymno where I offer volunteer work. All immigrants who participated in the survey enjoy the free services of the clinic. It should be stated that there was great distrust by many immigrants to answer the questionnaire. Despite the fact that there was the assurance by me that the questionnaire is anonymous and for research work for the University, almost one in two refused to participate in the research. Overall, while I approached about 30 immigrants only 15 of them responded. Many of them refused to participate in the survey because they do not have the legal documents for their stay in Greece.

The main conclusions drawn from the research are the following: The survey involved 15 subjects, 8 males and 7 females. The distribution of our sample between the sexes is 53.33% male and 46.67% female (Question – chart 1)



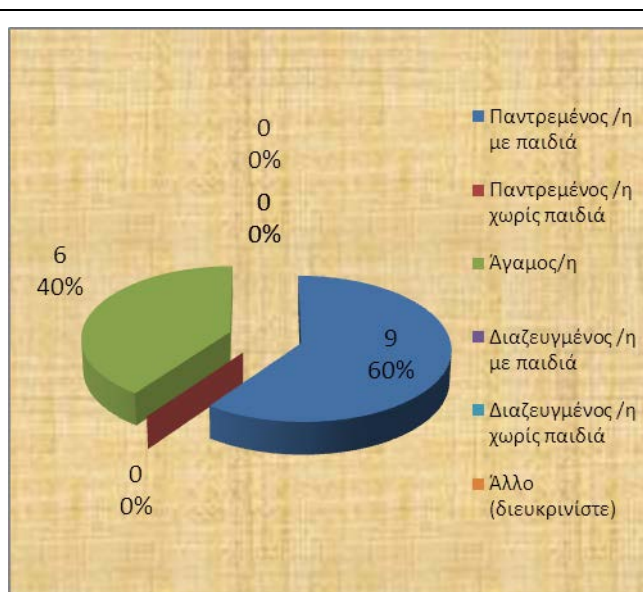
Regarding age, most of them belong to the productive age group: 26.67% are 19-24 years old, 13.33% 25-34 years old, 33.33% are 35-44 years old, 20.00 % are 45-54 years old and 6.67% are over 55 years old. In total, the age between 19 to 44 years old is 73.33% of immigrants, while above 45 is 26.67%. (Question - chart 2).



Regarding marital status, unmarried is 40% of immigrants in our sample, married with children is 60%, while other groups did not show distribution. (Question-chart 3).

Question – chart: 3		
Marital status	Number of answers	Frequency (%)
Married with children	9	60,00%
Married without children	0	0,00%
Unmarried	6	40,00%
Divorced with children	0	0,00%
Divorced without children	0	0,00%
Other (specify)	0	0,00%
Total	15	100%

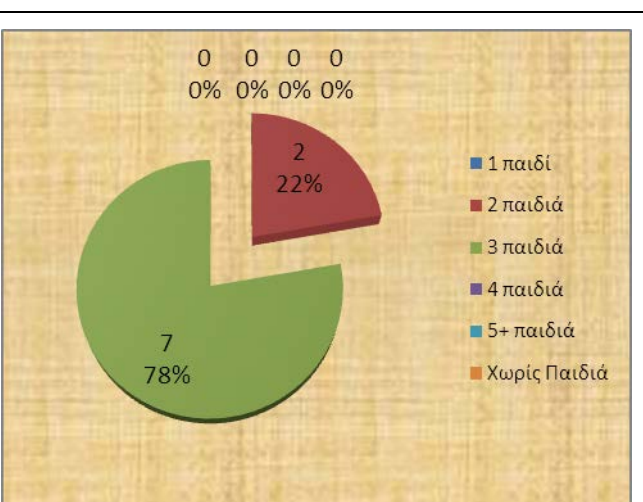
(Παντρεμένος με παιδιά=Married with children, Παντρεμένος χωρίς παιδιά= Married without children, Άγαμος=Unmarried, Διαζευγμένος με παιδιά= Divorced with children, Διαζευγμένος χωρίς παιδιά= Divorced without children, Άλλο-διευκρινίστε= Other (specify))



Of the nine immigrants who reported having children, the vast majority of them have 3 children (77.78%) while 13.33% had 2 children. While other groups do not have any distribution. (Question-chart 4).

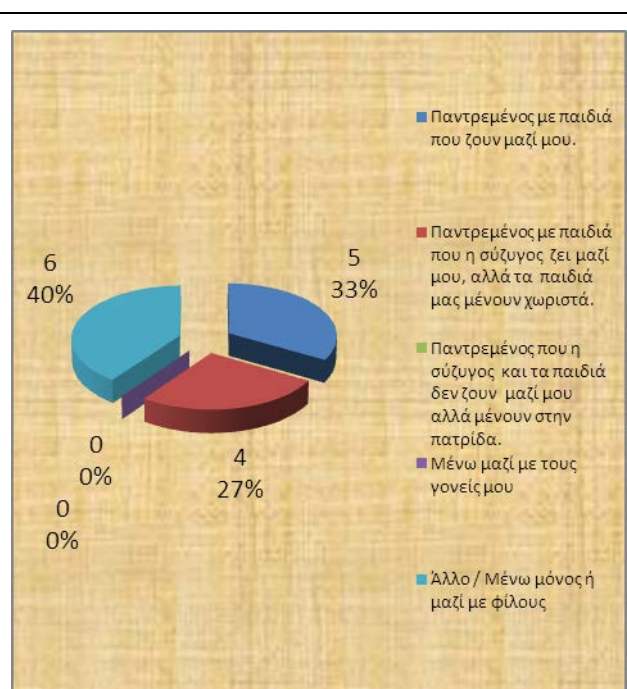
Question – chart: 4		
Marital status/number of children	Number of answers	Frequency (%)
1 child	0	0,00%
2 children	2	22,22%
3 children	7	77,78%
4 children	0	0,00%
5+ children	0	0,00%
Without children	0	0,00%
Total	9	100%

(1 παιδί=1 child, 2 παιδιά=2 children, 3 παιδιά=3 children, 4 παιδιά=4 children, 5+παιδιά=5+ children, Χωρίς παιδιά= Without children)



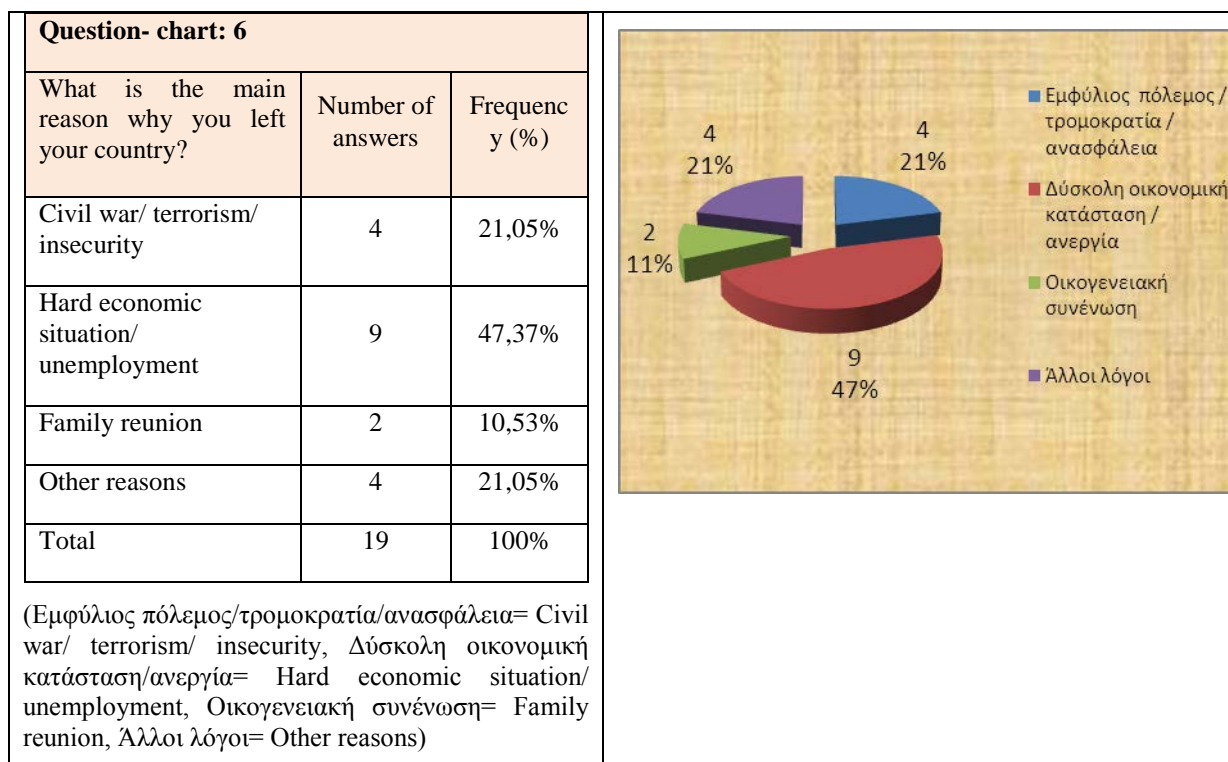
Regarding the situation of the household, 33.33% are married with children living with them, the 26.67% are married with children whose wife lives with them but their children live separately, while the proportion of those living alone or with friends, is 40%. (Question-chart 5).

Question- chart: 5		
Household status	Number of answers	Frequency (%)
Married with children living with me.	5	33,33%
Married with children my wife lives with me, but the children live separately.	4	26,67%
Married, wife and children do not live with me but they live in the homeland.	0	0,00%
I live with my parents	0	0,00%
Other / I live alone or with my friends	6	40,00%
Total	15	100%

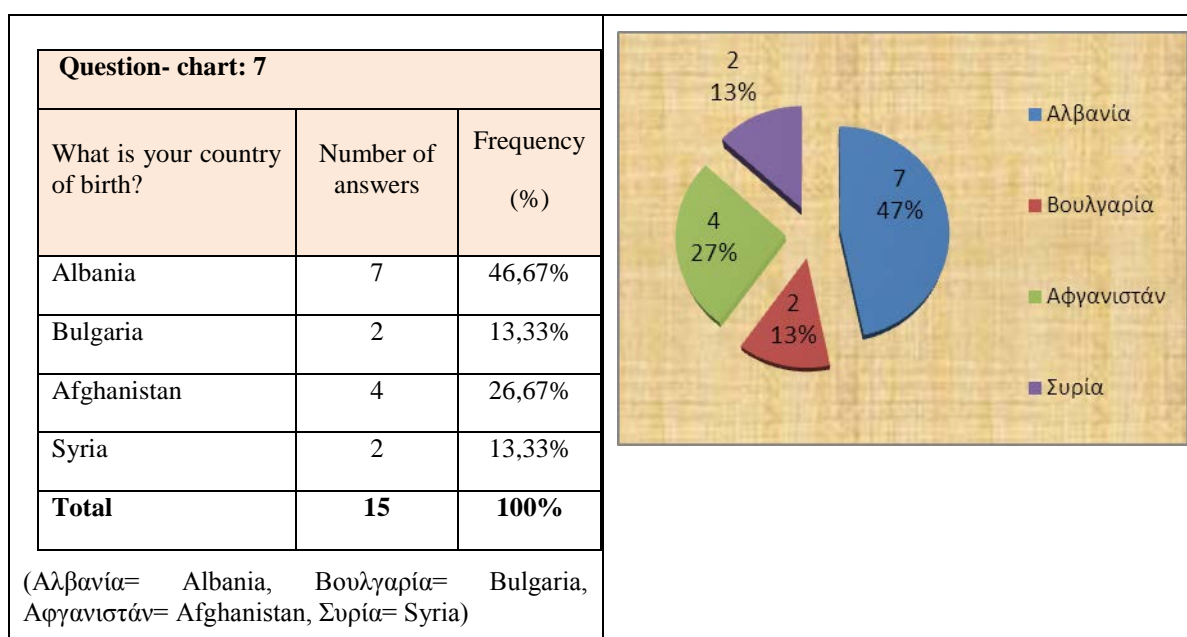


(Παντρεμένος με παιδιά που ζουν μαζί μου= Married with children living with me, Παντρεμένος με παιδιά που η σύζυγος ζει μαζί μου, αλλά τα παιδιά μας μένουν χωριστά= Married with children my wife lives with me, but the children live separately, Παντρεμένος που η σύζυγος και τα παιδιά δεν ζουν μαζί μου αλλά μένουν στην πατρίδα= Married, wife and children do not live with me but they live in the homeland, Μένω μαζί με τους γονείς μου= I live with my parents, Άλλο, μένω μόνος ή μαζί με φίλους= Other / I live alone or with my friends)

As far as the reasons why they left their country are concerned, the relative majority (47.37%) of the immigrants in our sample left because of the difficult financial situation in their homeland, the 21.05% because of civil war and terrorism, the 10.53% for family reunion, while 21.05% for other reasons such as improving the quality of life, etc. (Question-chart 6).

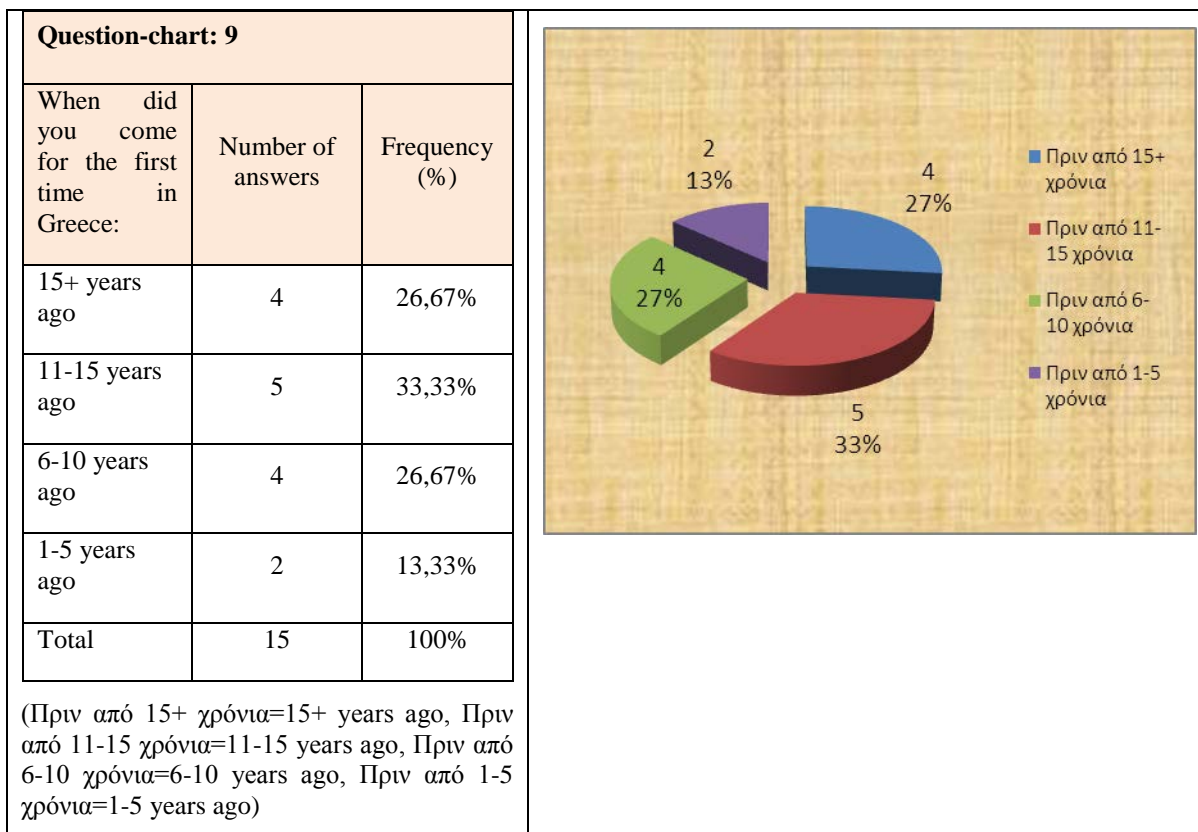


As far as the country of birth is concerned, 46.67% of our sample of immigrants was born in Albania, in Bulgaria 13.33%, 26.67% in Afghanistan and 13.33% in Syria. (Question-chart 7).

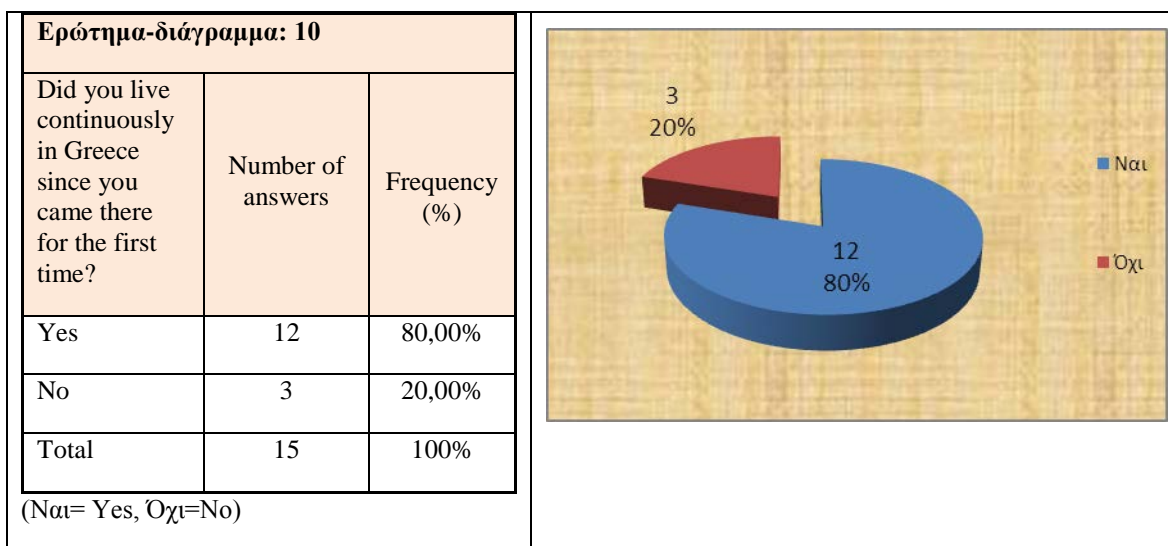


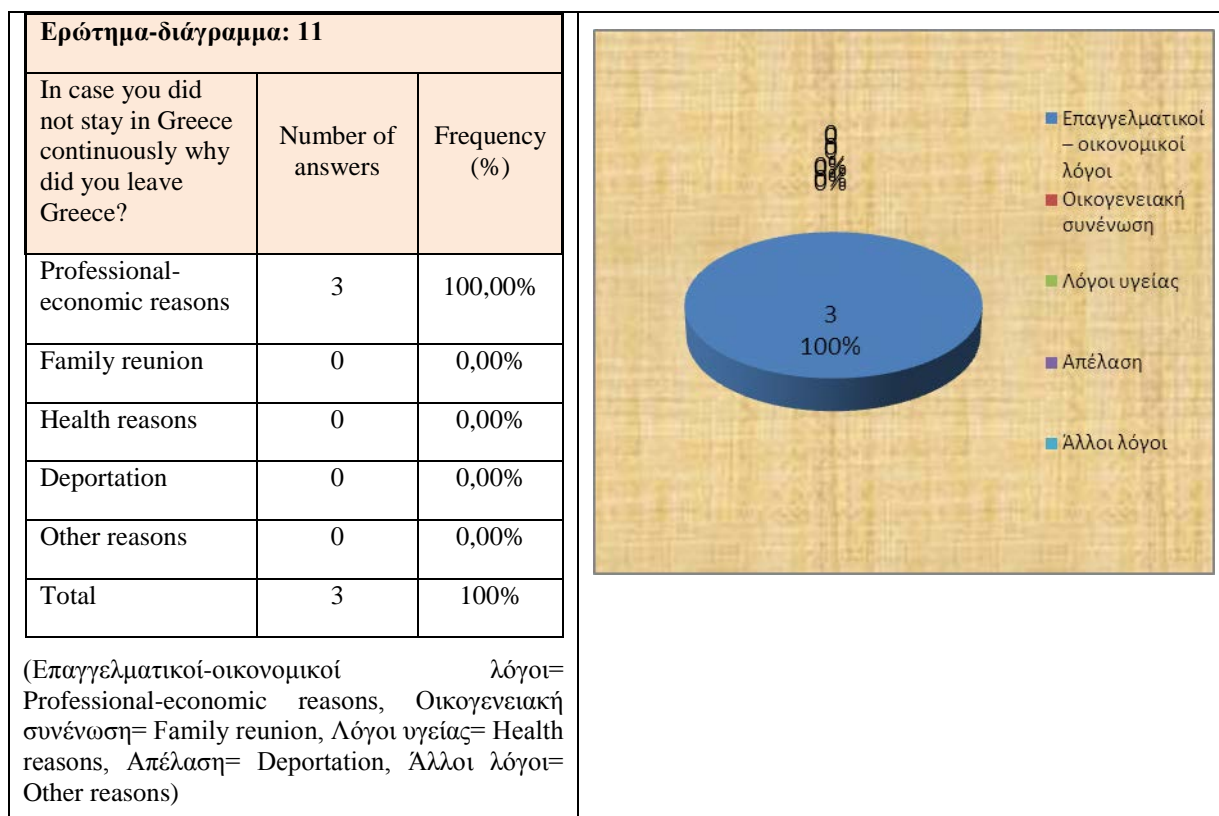
Regarding ethnicity, 46.67% of the immigrants in our sample reported having Albanian, Bulgarian 13.33%, 26.67% Afghan and 13.33% Syrian ethnicity. Overall, the people coming from the Balkan countries of the former socialist are about 60.00%, while 40.00% from Asian countries. (Question-chart 8).

The 26.67% of them came to Greece at least 15 years ago (before 1997), 33.33% before 11-15 years, 26.67% 6-10 years ago and 13.33% 1-5 years ago. This means that over half of immigrants (60%) is more than ten years in Greece (Question-chart 9).

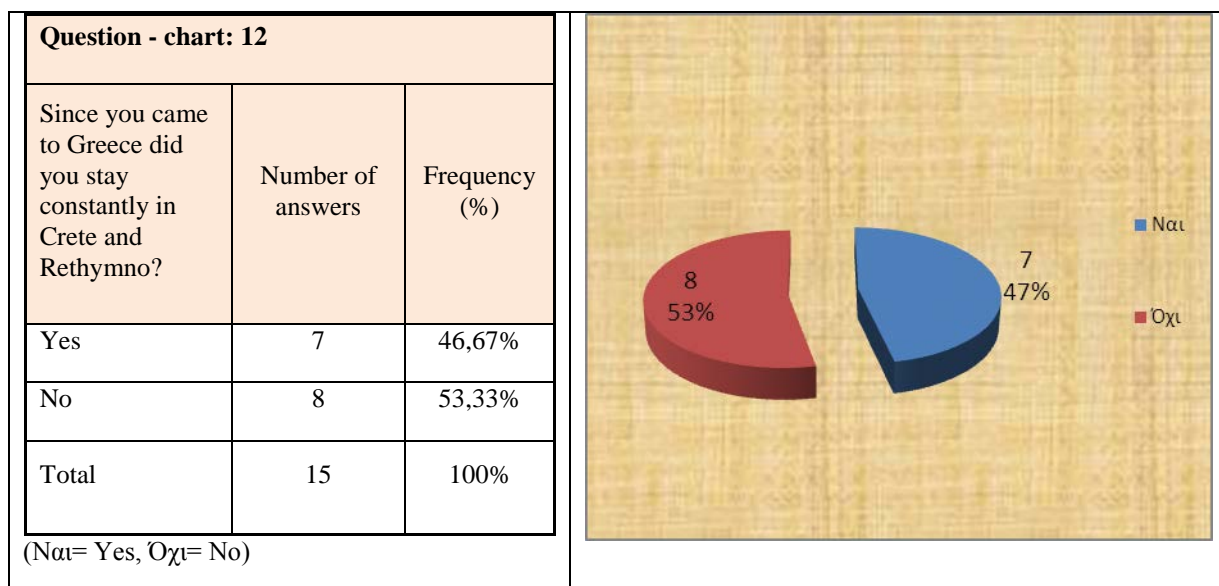


Also, 80% of immigrants in our sample, stays continuously in Greece since they came for the first time and only 20% have gone somewhere else for some time (Question-graph 10), and they all left mainly for business - economic reasons. (Question-chart 11).

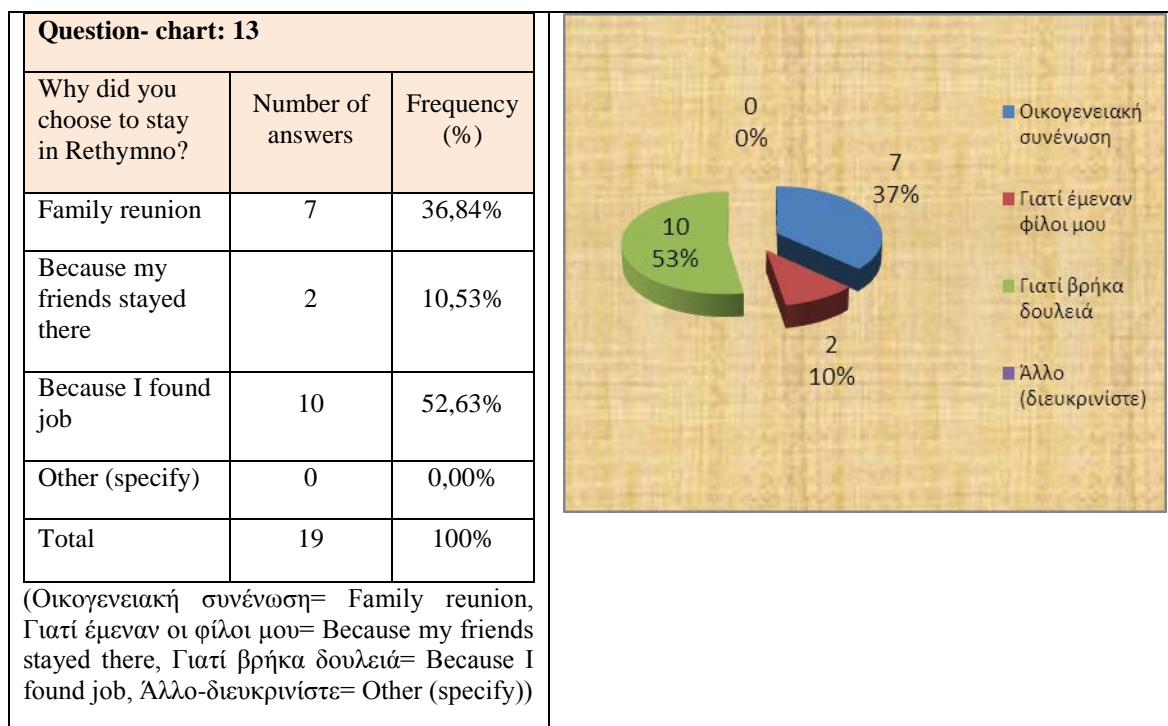




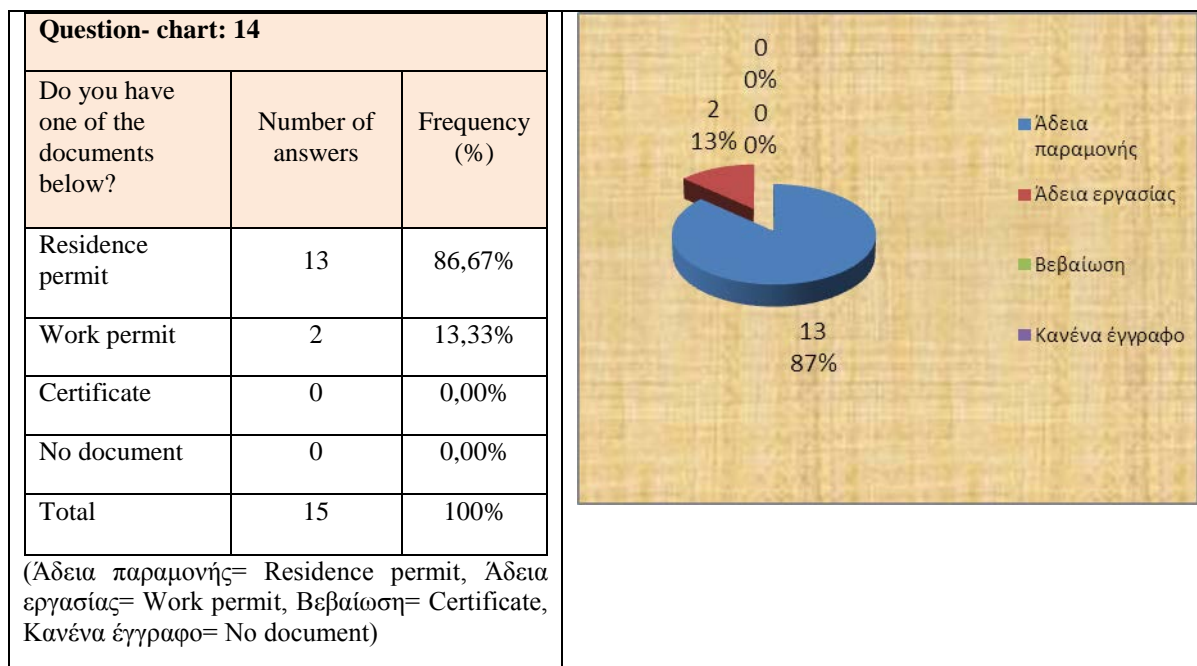
Normally immigrants stay for a long time in Crete and Rethymno. The 46.67% of them stay constantly in Crete and in Rethymno since they came to Greece, while 53.33% have moved to other areas. (Question-chart 12).



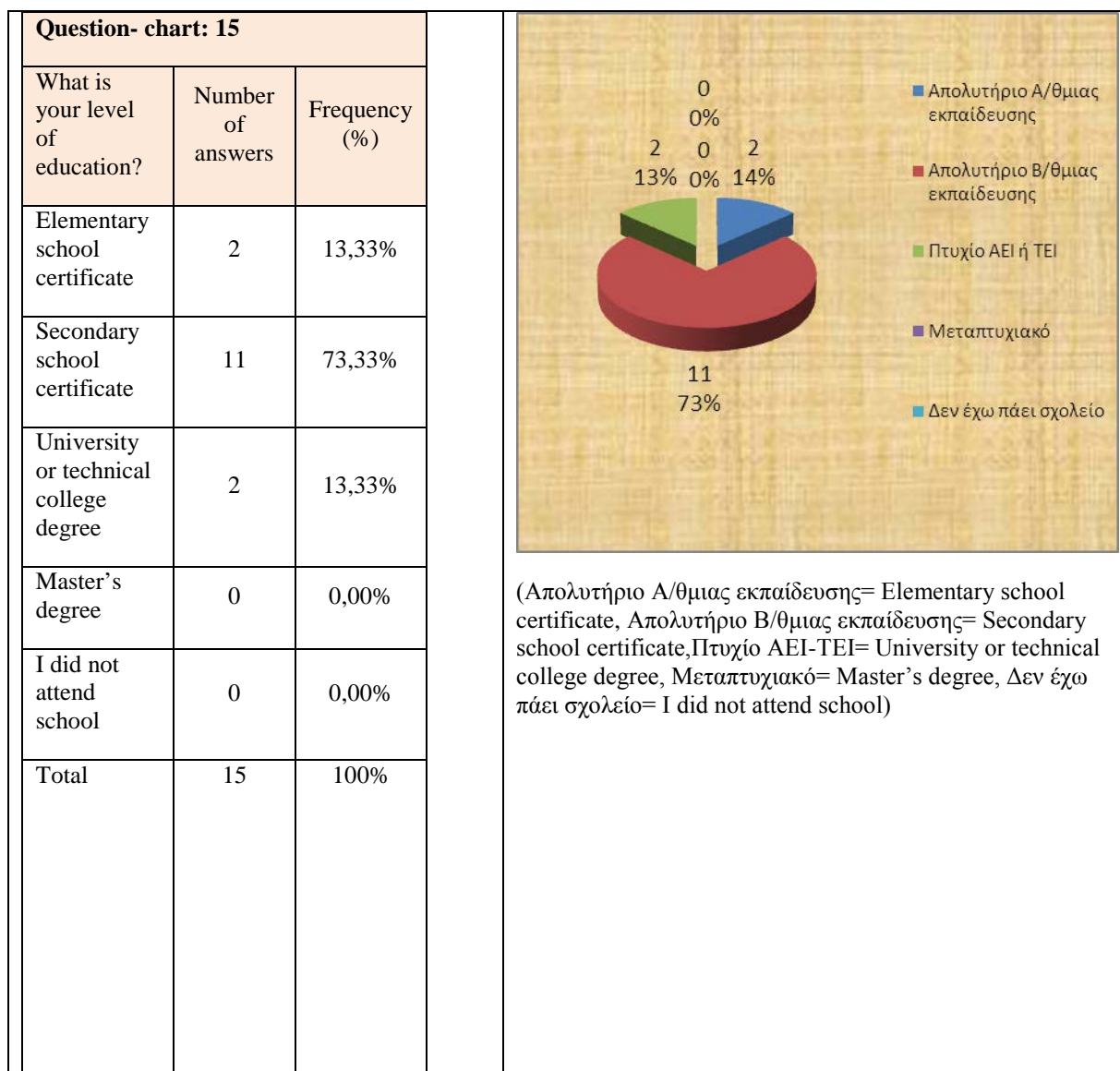
A large number of immigrants (52.63%) chose to settle in Rethymno because they found job, 36.84% for family reunion, while 10.53% because their friends had already settled in Rethymno. (Question-chart 13).



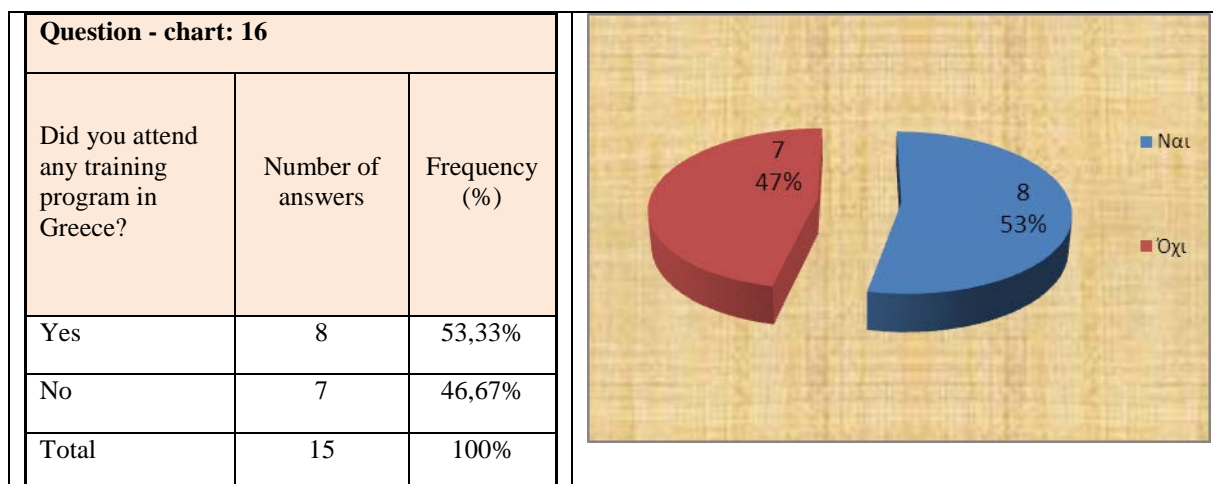
About the status of the residence of immigrants of our sample in Greece, 86.67% said that they have a work permit and 13.33% said they have a permit. (Question-chart 14).



The educational level of immigrants in the sample is relatively high. The 73.33% said that they have school certificate of Secondary Education and 13.33% university degree or technical college degree, while only 13.33% is of the level of Elementary Education. It is observed that 86.67% of the immigrants in our sample have a higher education and university degree, which have been acquired before settling in Greece from the country of their origin. (Question-chart 15).

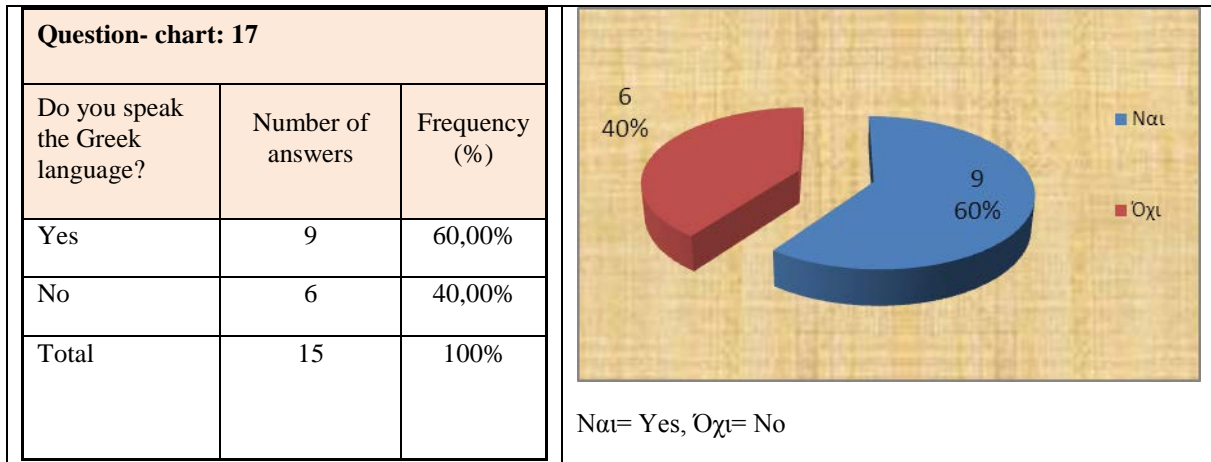


Also, the proportion of those who have attended a training program in Greece is relatively high, since 53.33% responded positively to this question while 46.67% replied negatively. (Question-chart 16).

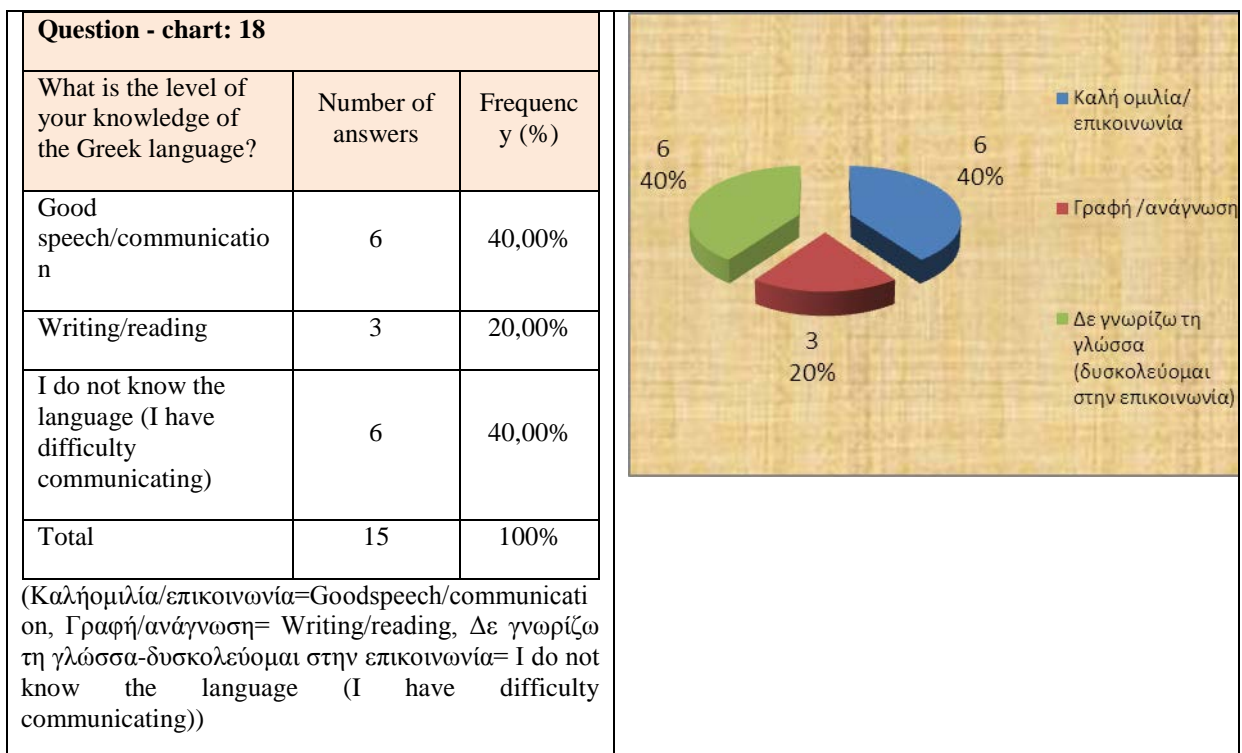


Ναι= Yes, Όχι= No

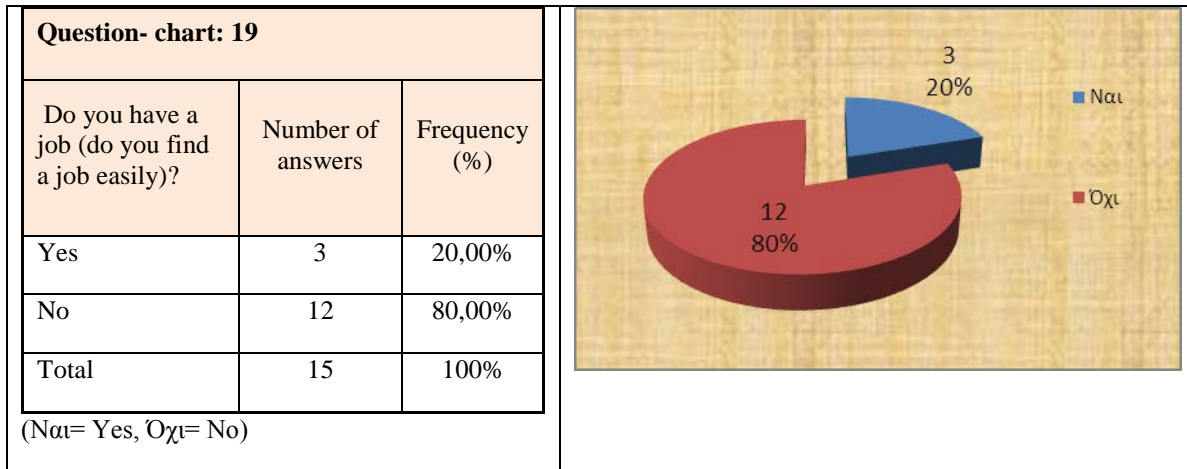
Then, it is observed that the immigrants of the sample in the majority say that they speak the Greek language. More specifically, 60.00% of the respondents answered that they are familiar with the Greek language, while 40.00% reported that they faced difficulties with the language. (Question-chart 17).



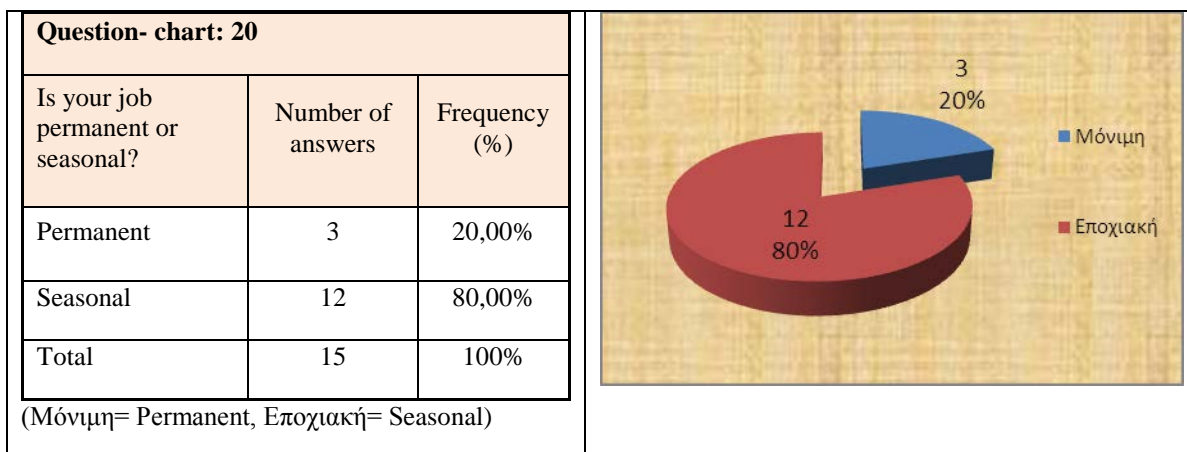
The previous finding is confirmed by the responses to the question about the level of knowledge of the Greek language. 40.00% of the immigrants in the sample said that they speak the language well and have no problems in communication, 20.00% also knows reading and writing, while 40.00% does not know the language well and have problems in communication. It should be noted that the immigrants who face communication problems come from Afghanistan and Syria, and they also have fewer years of stay in Greece. (Question-chart 18).



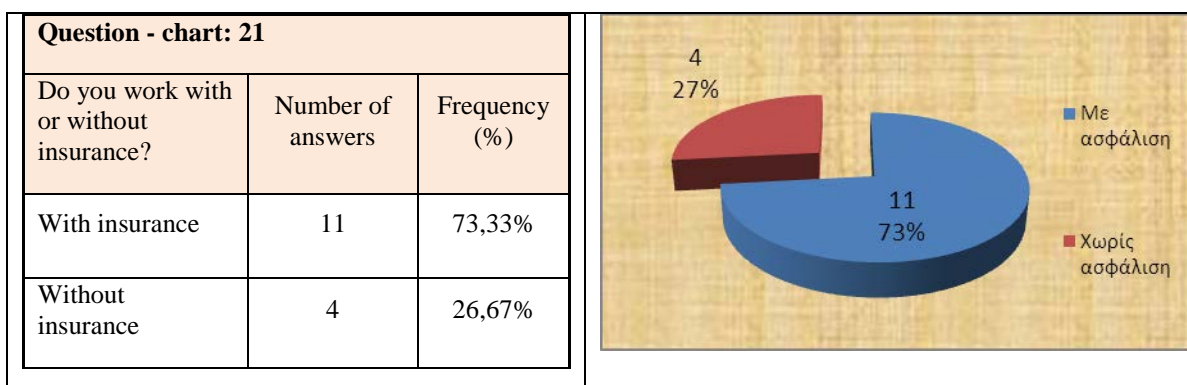
Regarding the possibilities of finding a job, the vast majority of immigrants in the sample said that they can hardly find a job. In particular, in the question "do you find job easily," 80.00% responded negatively, while only 20.00% responded positively. (Question-chart 19).



Also, 80.00% of the immigrants in the sample reported that they do not have a permanent job and only 20.00% of them answered that they have permanent employment. It should be pointed out that those who reported that they have permanent employment were women who took care of the elderly. (Question-chart 20).



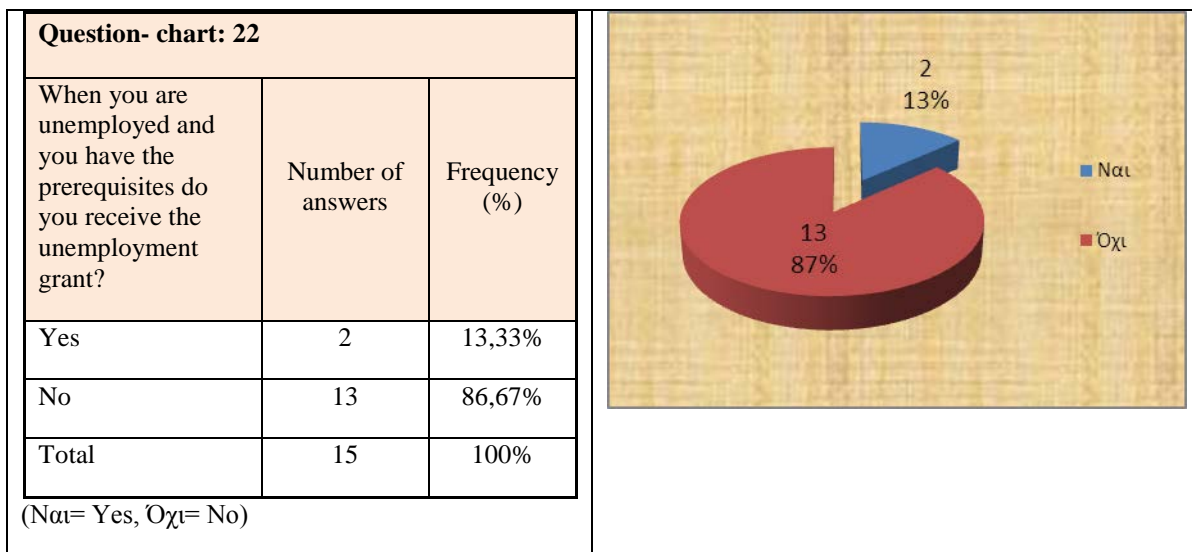
As far as their insurance is concerned, the majority of immigrants in our sample are insured. Specifically, 73.33% of the respondents are insured, while 26.67% said they are uninsured. The percentage of immigrants who say that they are uninsured is large and they are likely to work under "black" labour status. (Question-chart 21).



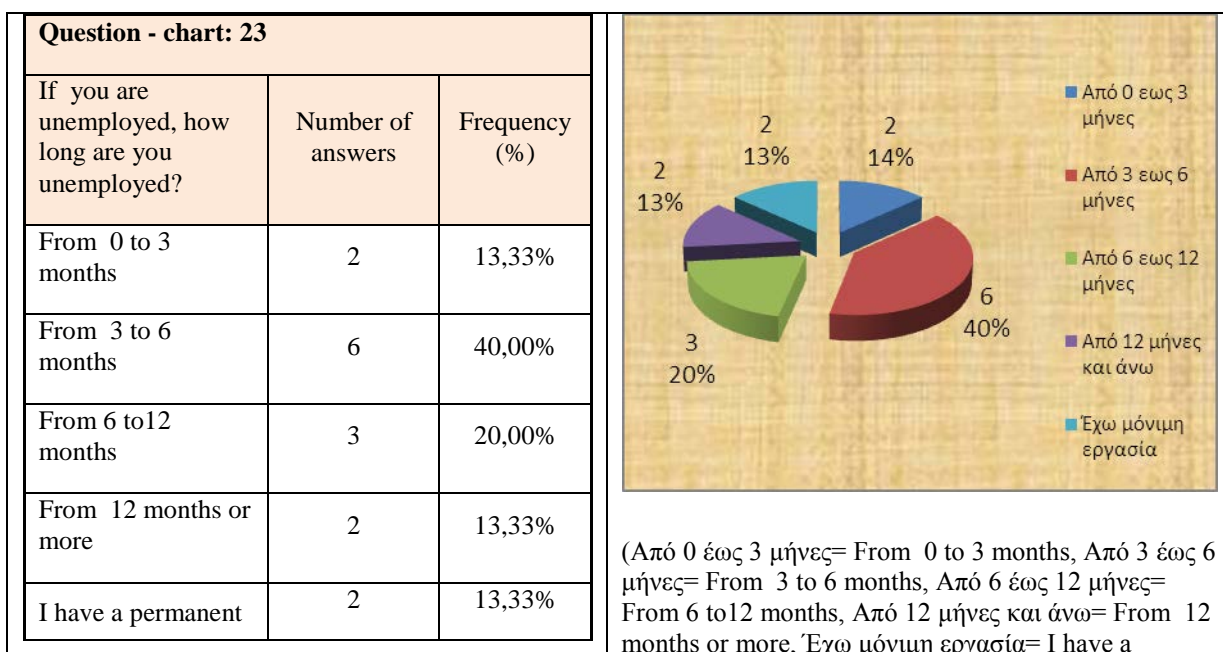
Total	15	100%
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(Με ασφάλιση= With insurance, Χωρίς ασφάλιση= Without insurance)

Furthermore, in the case of those who are unemployed and are eligible to receive the unemployment grant, the vast majority 86.67% answered that they did not receive it, while 13.33% said that they receive it. The fact that unemployed immigrants do not receive the unemployment grant may be due either to uninsured “black” labour which in many cases is the work status for many immigrants or to lack of knowledge and information about their rights, or to the failure to satisfy the prerequisite conditions necessary for the consolidation of the unemployment grant. (Question-chart 22).

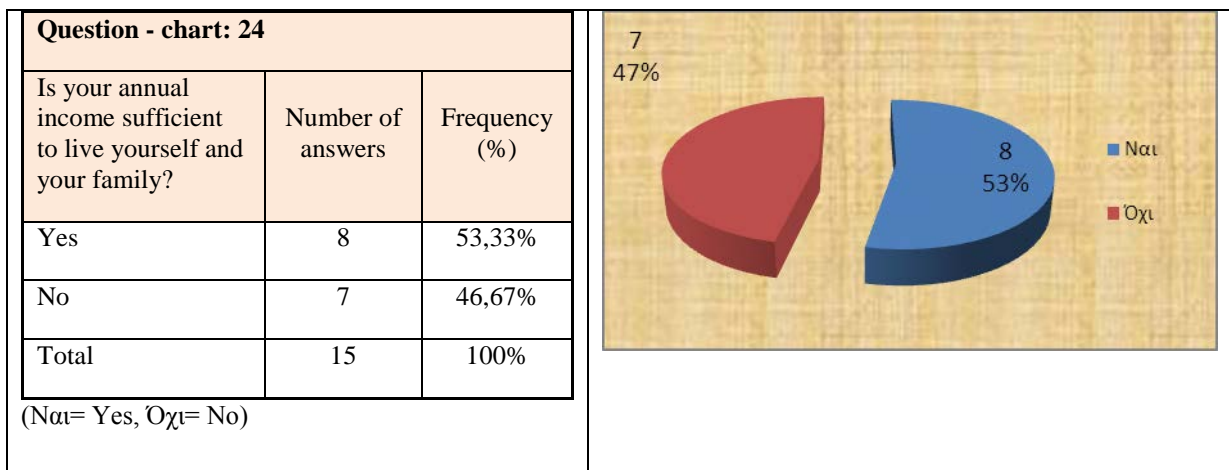


Unemployment is very common among immigrants. Unemployed immigrants reported that they are continuously unemployed as follows: From 0 to 3 months 13.33%, from 3 to 6 months 40.00%, from 6 to 12 months 20.00%, from 12 months or more 13.33% and only 13.33% said that they have a permanent job and are not affected by unemployment. (Question-chart 23).



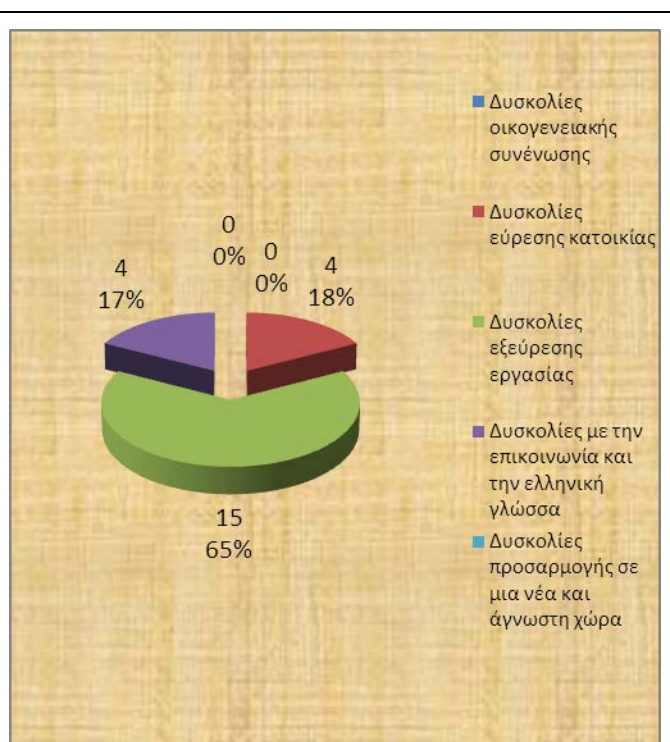
job			permanent job)
Total	15	100%	

To the question if the annual income is sufficient to live himself and his family, 53.33% responded positively, while 46.67% were negative. It is characteristic that those who have family responsibilities (children in school, etc.) answered negatively, while those without family obligations replied positively. (Question-chart 24).



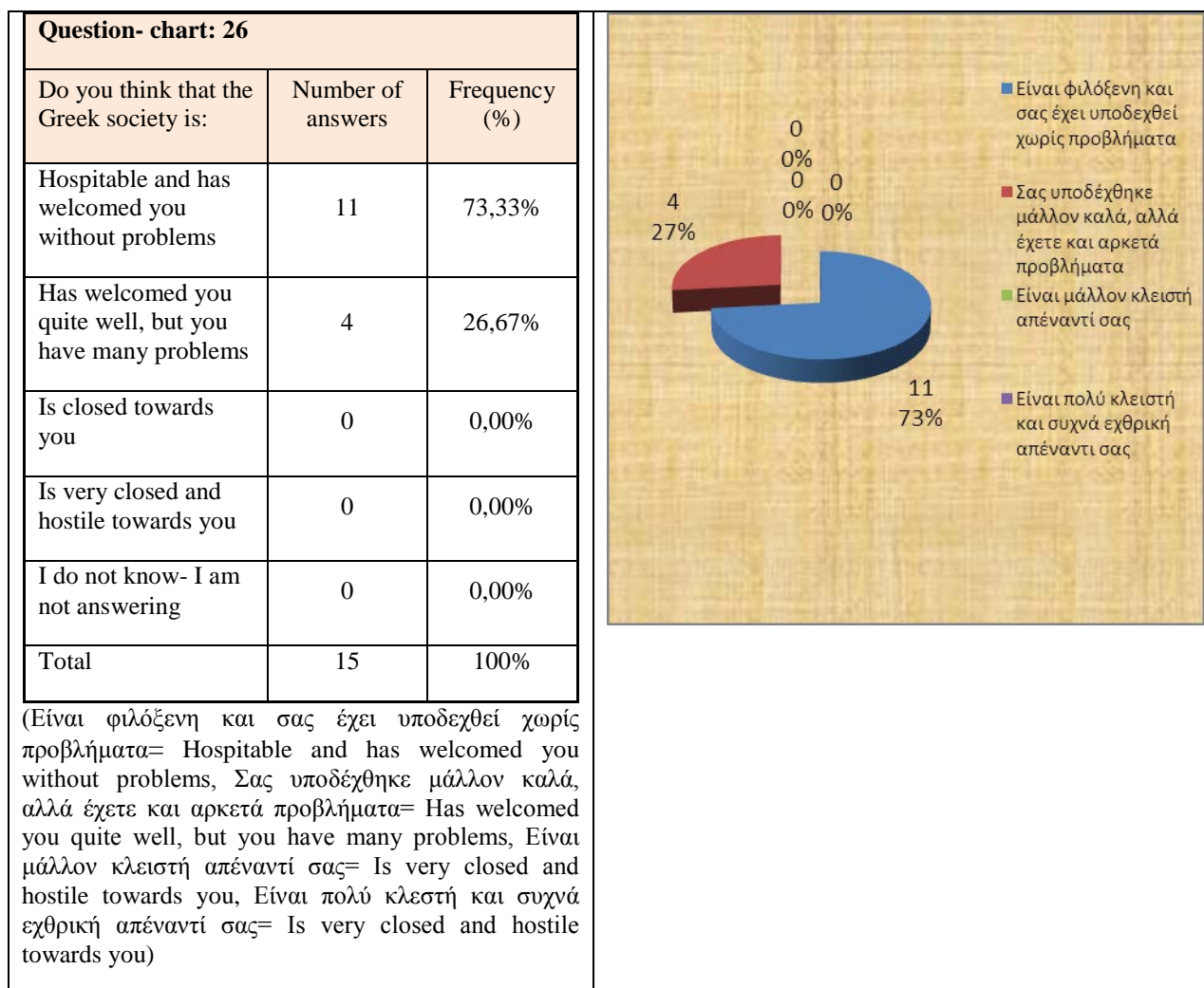
To the question about the main difficulties encountered while settling in Greece, these were classified as follows: difficulties finding work 65.22%, difficulty finding accommodation 17.39% and difficulties in communication and the Greek language 17.39%. It is also characteristic that the difficulties adjusting to a new and unknown country were not evaluated as well as the difficulties in family reunion. (Question-chart 25).

Question- chart: 25		
What were the main difficulties during your settlement in Greece?	Number of answers	Frequency (%)
Difficulties in family reunion	0	0,00%
Difficulties in finding accommodation	4	17,39%
Difficulties in finding a job	15	65,22%
Difficulties in communication and the Greek language	4	17,39%
Difficulties in adjusting to a new and unknown country	0	0,00%
Total	23	100%

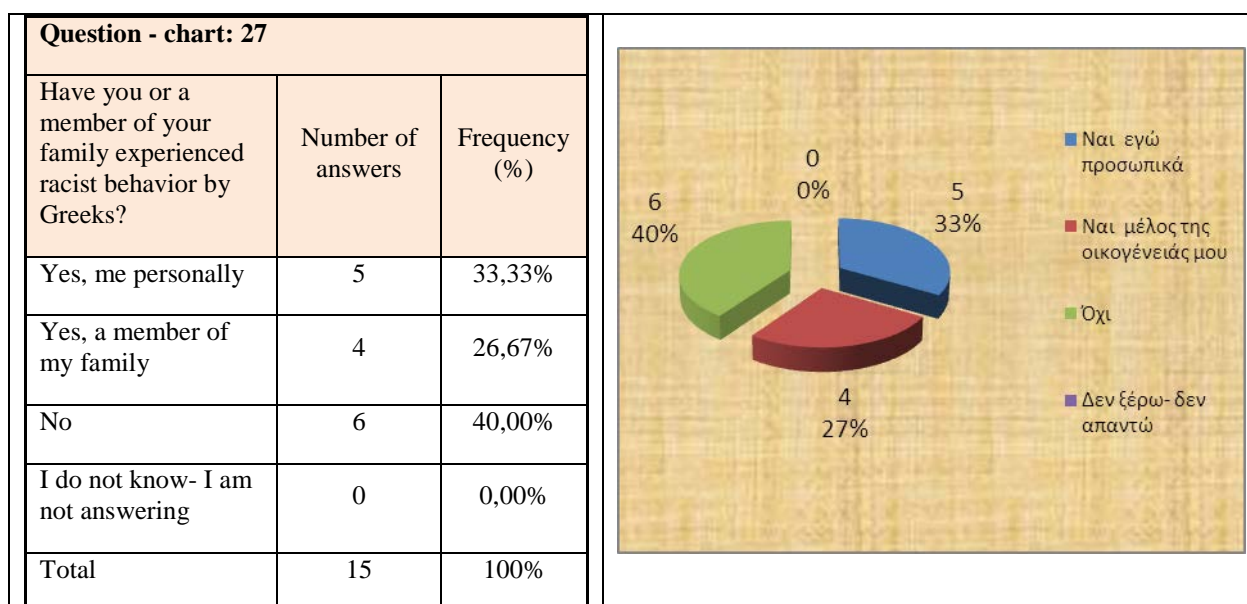


Δυσκολίες οικογενειακής συνένωσης= Difficulties in family reunion, Δυσκολίες εύρεσης κατοικίας= Difficulties in finding accommodation, Δυσκολίες εξεύρεσης εργασίας= Difficulties in finding a job, Δυσκολίες με την επικοινωνία και την ελληνική γλώσσα= Difficulties in communication and the Greek language, Δυσκολίες προσαρμογής σε μια νέα και άγνωστη χώρα= Difficulties in adjusting to a new and unknown country

When asked about how the immigrants themselves see their confrontation by the Greek society, 73.33% believe that the Greek society is hospitable and have welcomed them without problems, 26.67% said they were welcomed quite well but they face several problems. It is surprising that no immigrant characterized the Greek society as closed and hostile towards him. (Question-chart 26).



To the question if s/he or a family member has experienced racist behavior by the Greeks, the majority 60.00% responded positively (33.33% himself and 26.67% family member), while 40.00% replied negatively. This result highlights the fact that the Greek society is characterized by xenophobia and racism. (Question-chart 27).

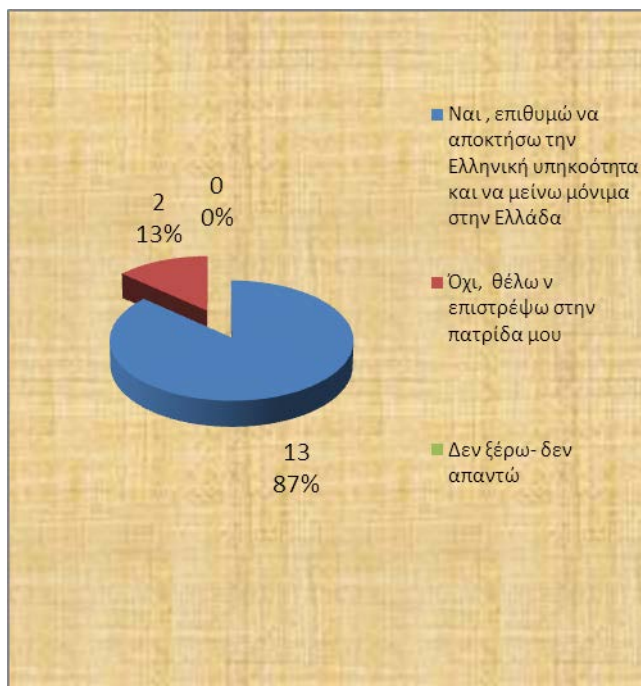


(Ναι εγώ προσωπικά= Yes, me personally, Ναι μέλος της οικογένειάς μου= Yes, a member of my family, Όχι= No, Δεν ξέρω-δεν απαντώ= I do not know- I am not answering)

The vast majority (86.67%) of the immigrants of our sample wish to obtain the Greek citizenship and stay permanently in Greece, while only 13.37% want to return back to their homeland. (Question-chart 28).

Question - chart: 28

Do you wish to obtain the Greek citizenship and stay permanently in Greece?	Number of answers	Frequency (%)
Yes, I wish to obtain the Greek citizenship and stay permanently in Greece	13	86,67%
No, I want to return back to my homeland	2	13,33%
I do not know- I am not answering	0	0,00%
Total	15	100%

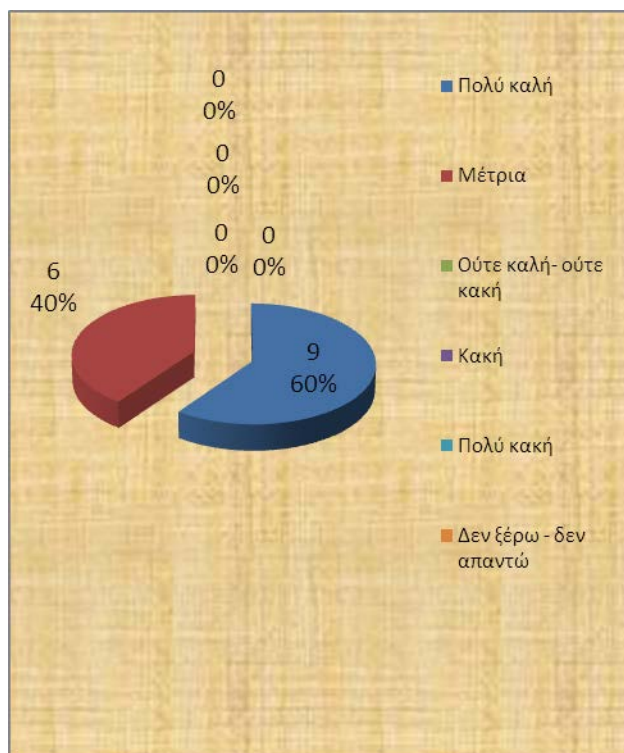


Ναι επιθυμώ να αποκτήσω την ελληνική υπηκοότητα και να μείνω μόνιμα στην Ελλάδα= Yes, I wish to obtain the Greek citizenship and stay permanently in Greece, Όχι θέλω να επιστρέψω στην πατρίδα μου= No, I want to return back to my homeland, Δεν ξέρω-δεν απαντώ= I do not know- I am not answering)

The immigrants were satisfied of the service by the public-social bodies they come in contact with. In particular, 60.00% considered their service by the public - social organizations very good, while 40% moderate. It is characteristic that no one evaluated negatively these entities. (Question-chart 29).

Question - chart: 29		
How do you assess the service by the public agencies you come in contact with, Police Municipality, etc?	Number of answers	Frequency (%)
Very good	9	60,00%
Moderate	6	40,00%
Neither good-nor bad	0	0,00%
Bad	0	0,00%
Very bad	0	0,00%
I do not know-I am not answering	0	0,00%
Total	15	100%

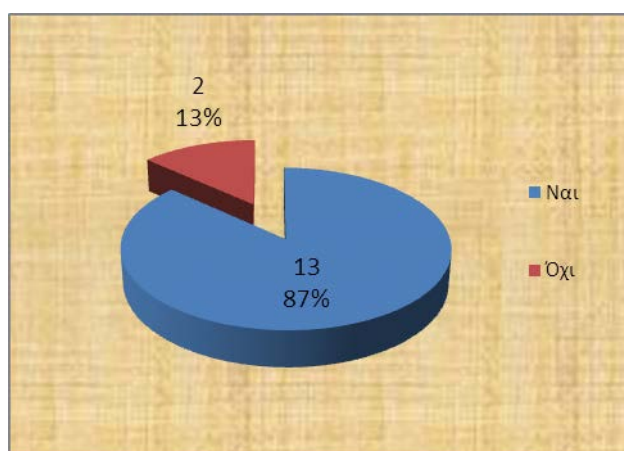
(Πολύ καλή= Very good, Μέτρια= Moderate, Ούτε καλή-ούτε κακή= Neither good-nor bad, Κακή= Bad, Πολύ κακή= Very bad, Δεν ξέρω-δεν απαντώ= I do not know- I am not answering)



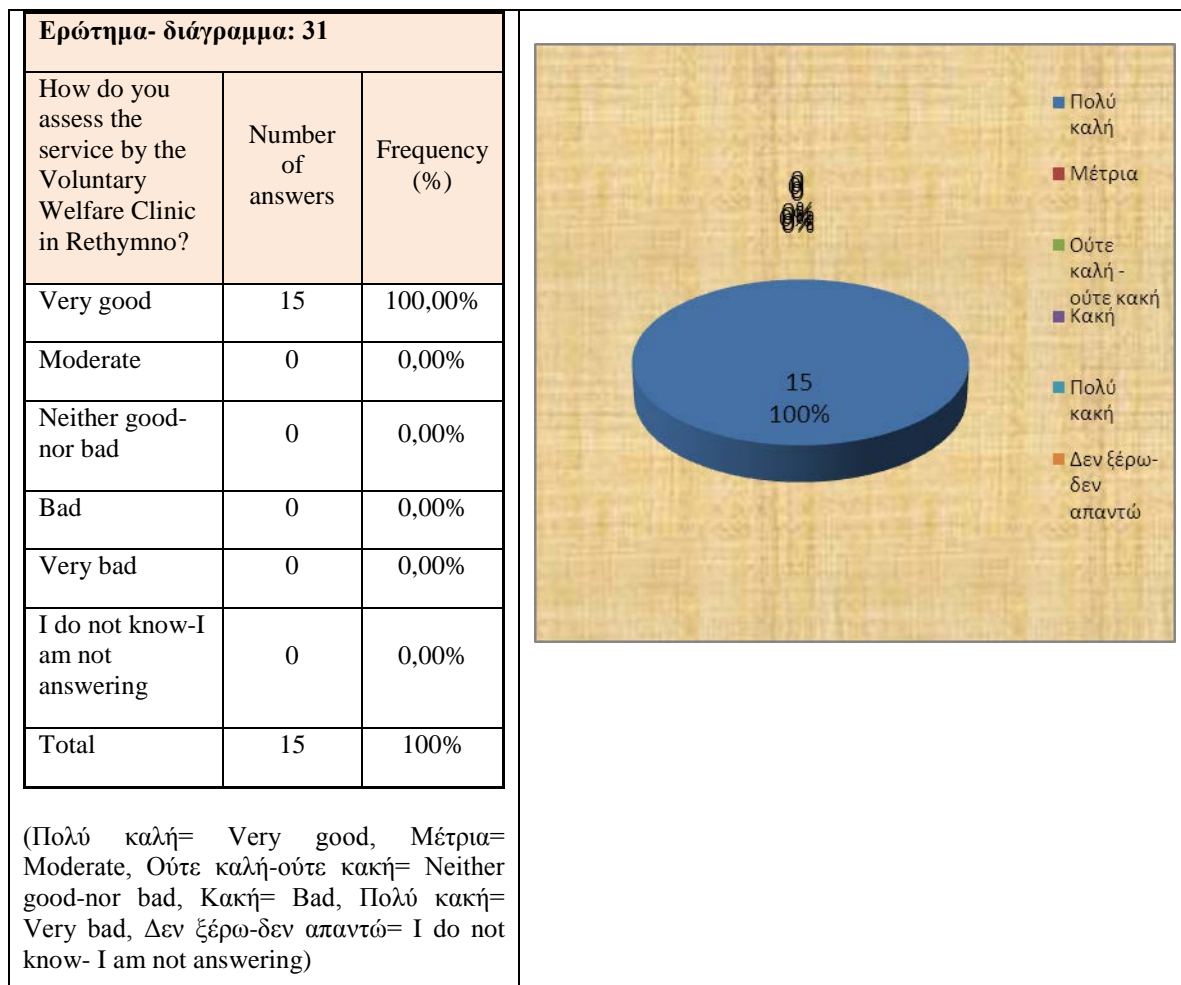
About health care, the vast majority of immigrants in our sample (86.67%) stated that they are insured in an insurance organization that provides health care, while only 13.37% do not have health care. (Question-chart 30).

Question - chart: 30		
Are you insured in an insurance organization that provides you health care;	Number of answers	Frequency (%)
Yes	13	86,67%
No	2	13,33%
Total	15	100%

(Ναι= Yes, Όχι= No)



The immigrants in our sample reported that they are completely satisfied with their service from the Voluntary Welfare Clinic in Rethymno (100.00%). This result is absolutely normal and indicates the important role of the clinic in the effort to promote the social integration of immigrants. (Question-chart 31).



General Conclusions-Epilogue

The rapid changes in the period after 1985 in immigration show the expansion of the phenomenon of immigration inflow for all countries of the European Union. More specifically, Greece traditionally a country "exporting" immigrants changed in the 1990's in a "host» country for many who left their homes to seek a better life.

In Crete and Rethymno in particular, there was a relatively high influx of immigrants, compared with other regions of the country, because of the employment opportunities for foreigners in the area.

The results of the survey conducted show that the majority of immigrants came in Rethymno in order to settle and live here for a long time. This is mainly for families with children, but also unmarried immigrants, in the most productive and reproductive phase of their life. The main cause why they left their country was on the one hand the difficult economic situation in it (mainly in Balkan countries) and on other hand the war and terrorism (Afghanistan). From their answers it becomes evident that their settlement in Greece and especially in Rethymno is conscious and intended and they show extreme stability for their stay in the same place.

The vast majority of immigrants in our sample wishes and seeks to remain in Greece. The critical question " are you thinking to settle permanently in Greece" the responses are dramatically in favor of a permanent settlement in Greece distributed as follows: yes 52%, not 48%.

The majority of immigrants in our sample have an average educational level as they have a certificate of higher secondary education which was acquired before settling in Greece. Moreover,

their participation in training programs is relatively high. Furthermore, the majority of them speak the Greek language, at least at the level of communication with the community around them as well as reading. However, it is quite a high percentage of those who said they have problems with the language therefore, they have difficulty communicating with the social environment (mainly those who have a few years of stay in Greece).

Most immigrants in our sample have difficulty finding work, and the majority of them do not have permanent jobs. Although they have insurance, the phenomenon of uninsured (black) labor is common. Unemployment is also a common phenomenon for immigrants and their annual incomes are not sufficient to meet their family obligations.

The majority of immigrants evaluate as favorable their living conditions and those of their family in their new host country. The main difficulty they face is the difficulties of finding work. As to whether they like now living in Greece, the result reveals an overwhelming majority with a positive response. To the critical question "Do you want to obtain the Greek citizenship and stay permanently in Greece," the answers are strikingly in favor of staying and the rate reaches 86.67%.

The relationship between immigrants and state and public entities, as well as the local community, proves very important for the process of integration in Greek society. It is significant that they have a positive view for the public - social bodies with which they come in contact. Also, despite the fact that immigrants in our sample have experienced themselves or a family member racist behavior, they assess that the local community is welcoming and they do not face any problems.

Furthermore, they are very satisfied with the services provided by the Voluntary Welfare Clinic in Rethymno. This result highlights the important role of the clinic in an effort to facilitate the immigrants' social integration in the local community.

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THE INFLUENCE OF EUROPEAN CONVENTION FOR THE PROTECTION ON HUMAN RIGHTS AND FUNDAMENTAL FREEDOMS UPON ROMANIAN SUCCESSIONAL LAW RELATIONS

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Abstract:

The paper is reviewing the influence of European Convention on Human Rights upon Romanian successional law from several terms or ways of :

This one is reviewed in term of principles of rule of law and subsidiarity, two important principles in European Protection of Human Rights Law , the first one being close connected to rule of law state and authentic democracy and the second one being close connected to state's involvement in legislative cadre of human rights creation and their respect's controle, in term of right to respect private and family life, a conditional and interdependent with liberalities and legal and testamentary successions matter right and in term of protection of property , which is including the general principle of right of property 's respect , a real principal right.

This one is reviewed by way of right to marry, which means also right to marry for that matter and to found a family of man and woman which have legal age , by way of equality between spouses , which is gathering way in civil rights and obligations field and by way of general principle of prohibition of discrimination, an european and international principle, too.

The paper is studying the relations between national law and european human rights protection law, a matter mainly regulated in internal law by Romanian Constitution and res interpretata of European Court of Human Rights decisions , which are producing in that term effects erga omnes.

We are suggesting the amendment of European Convention on Human Rights by an Additional Protocol, which is regulating the right to inherit of persons , as a human and a civil right, too

Key Words: European Convention on Human Rights successional law will family life property right to marry equality between spouses

Introduction

After the Second World War, the concern for protection of human rights in Europe became a major one.

The Western Europe States stood on civil and political rights and the Eastern Europe States stood on economic and social ones.

The Council of Europe had a major role in protection of human rights , which has the purpose "to realize a bigger unity between his members for their ideals protection and fulfillment which are their comun inheritance and to facilitate their economic and social progress " , according to Art.1 Letter a from its Statute.

European Convention for the Protection on Human Rights and Fundamental Freedoms and Protocols to the Convention

European Convention for the Protection on Human Rights and Fundamental Freedoms was signed beginning from November 4th 1950, in Rome and came into effect on September 3rd 1954.

The Convention was amended by fifteen Protocols : fourteen Protocols and Protocol No.14 bis , pursuant to national law in the Contracting Parties States and human rights and fundamental freedoms development.

From these , there are relevants in successional matter : Protocol No.1 to the Convention opened for signature in Paris, on March 20th 1952, which is stipulating in Art.1 the protection of property, Protocol No.7 to the Convention opened for signature in Strasbourg, on November 22th 1984, which is stipulating in Art.5 the equality between spouses and Protocol No.12 to the

Convention opened for signature in Rome, on November 4th 2000, which is stipulating in Art.1 the general prohibition of discrimination.

Protocol No.1 was ratified by Romania by Law nr.30 from 1994 published in Romania's Official Gazette No.135 from May 31st 1994 and amended by Protocol No.11 opened for signature in Strasbourg, on May 11th 1994 and ratified by Romania by Law nr.79 from 1995 published in Romania's Official Gazette No.147 from July 13th 1995.

Protocol No.7 was also ratified by Romania by Law nr.30 from 1994 and amended by Protocol No.11 and ratified by Romania by Law No.79 from 1995.

Protocol No.12 was ratified by Romania by Law No.103 from 2006 published in Romania's Official Gazette No.375 from May 2nd 2006.

Romanian legislation in succesional matter

The succesional matter is subject to the following Romanian legislative acts:

Romania's Constitution from 1991, which is the fundamental law, was amended and completed by Romania's Constitution Revision Law No. 429 from September 18th 2003 published in Romania's Official Gazette No.669 from September 22th 2003, republished in Romania's Official Gazette No.767 from October 31th 2003.

From ordinary laws there are:

Civil Code from November 26th 1864, which came into effect on December 1st 1865, that means Ancient Civil Code, which is also named Code Alexandru Ioan Cuza was published part by part: Art.1-347 in the Official Gazette No.271 from December 4th 1864 and Art.348-1914 in the Official Gazette No.7,8,9,11 and 13 from 1865 and its model is Napoleon Civil Code from 1804.

Law No.319 from June 10th 1944 concerning succesional right of survivor spouse, named also Decree-Law, was published in Romania's Official Gazette No.133 from June 10th 1944 and rectified in Romania's Official Gazette No.142 from June 21th 1944.

Civil Code from 2009-Law No.287 from 2009 concerning Civil Code, published in Romania's Official Gazette No.511 from July 24th 2009, amended by Law No. 71 from 2011 and rectified in Romania's Official Gazette No.427 from June 17th 2011 and Romania's Official Gazette No.489 from July 8th 2011, that means New Civil Code, was applied in basis of Law No. 71 from 2011 concerning applying Law No.287 from 2009, published in Romania's Official Gazette No.409 from June 10th 2011 and amended by Law No. 60 from 2012 concerning approval Government Urgency Ordinance No.79 from 2011 concerning regulating necessary measures for Law No.287 from 2009 regarding Civil Code entry into force, published in Romania's Official Gazette No.255 from April 17th 2012. It has in succesional matter two models: French Civil Code and Quebec Civil Code.

Law No.36 from May 12th 1995 concerning public notaries and notarial activity was published in Romania's Official Gazette No.92 from May 16th 1995, amended by Law No.267/2003 concerning amendment of art.3 Government Urgency Ordinance No.24 from 1992 regarding establishment consular services and fees for these services and art.13 Law No.36 from 1995, published in Romania's Official Gazette No.424 from June 17th 2003, by Government Urgency Ordinance No.25 from 2005 for abrogating art.31 Law No.36 from 1995, published in Romania's Official Gazette No.278 from April 4th 2005, approved by Law No. 178 from 2005 for approval of Government Urgency Ordinance No.25 from 2005 for abrogating art.31 Law No.36 from 1995, published in Romania's Official Gazette No.499 from June 13th 2005, amended by Government Urgency Ordinance No.166 from 2008 for amendment of art.16 letter a Law No.36 from 1995, published in Romania's Official Gazette No.789 from November 25th 2008, approved by Law No. 298 from 2009 for approval of Government Urgency Ordinance No.166 from 2008 for amendment of art.16 letter a Law No.36 from 1995, published in Romania's Official Gazette No.645 from October 1st 2009, amended by Law No. 71 from 2011 and republished in Romania's Official Gazette No.72 from February 4th 2013.

From other legislative acts there are Regulations for applying Law No.36 from 1995 concerning public notaries and notarial activity, approved by Ministry of Justice Order No. 710/C/1995, published in Romania's Official Gazette No.176 from August 8th 1995, amended by Ministry of Justice Order No. 1410/C/1996 for amendment of Regulations for applying Law No.36 from 1995 concerning public notaries and notarial activity, published in Romania's Official Gazette No.25 from February 15th 1995, amended by Ministry of Justice Order No. 2730/C/2008 for

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Civil Code from 1864 was abrogated on October 1st 2011, excepted art. 1169-1174 and 1176-1206 which were abrogated when Law No. 134 from 2010 concerning Civil Procedure Code, entered into force, on February 15th 2013, by Law No.71 from 2011.

Law No.319 from June 10th 1944 is complexe, even if it is brief.All this law is regulating succesional matter.Civil Code from 1864 did not acknowledged for the survivor spouse an equal legal regime with deceased's relatives.He or she came to inheritance after 12th degree relatives , before entering into force of Law No. 3581 from 1921 concerning progressive tax on inheritances and after 4th degree relatives , after entering into force of Law No. 3581 from 1921.Survivor spouse had an uncertain and unfavourable situation.By exception poor widow who came to inheritance in concurrence with the descendants had an undivided usufruct right for life, or an undivided quota of ¼ in undiminished property, when she came to inheritance in concurrence with the other deceased's relatives. Law No.319 from 1944 had improved survivor spouse's legal situation.

Law No.319 from 1944 was also abrogated on October 1st 2011, by Law No.71 from 2011.

Civil Code from 2009 came into effect on October 1st 2011.According to Art.91 Law No.71 from 2011 , New Civil Code is applied on successions opened after entering into force of this New Civil Code, that means October 1st 2011.Conditions to inherit , general principles of succesional devolution , rights of inheritance including heirs number and quality, succesional quotas, right of succesional option, including succesional option term, succesional transmission and all the others legal institutions of substantial law applied to successions opened before October 1st 2011 are subjects to law which is into force on date when succession is opened and the competence is the subject to new law.

We consider the most important sources of succesional law are Civil Code from 1864, Law No.319 from 1944 and Civil Code from 2009.

The influence of European Convention on Human Rights upon Romanian succesional law relations in terms of principles of rule of law and principles of subsidiarity

Principles of rule of law are mentioned in Preamble of Convention , but this one does not define it.

These principles are also specified in Preamble and Art.3 from Statute of the Council of Europe, but this one either does not define it.

Rule of law is sitting on comun patrimony of Member States of Council of Europe of moral, legal, political and social values.

Closely linked to state of rule of law and genuine democracy, these principles are a national and european value, without which protection of human rights and fundamental freedoms could not be achieved.

Even if these are not included in Convention's object and purpose, these are "constitutive elements of moral comun patrimony of Member States of Council of Europe."¹

Rule of law involves authorities constitution and working according to law, respect of law by public authorities and citizens and respect of court orders which are applying the law.

In a word rule of law involves reign of law, where law has the sense of legislation, that means ensemble of legislative acts adopted, entered into force and applied on a state territory.

In terms of rule of law we must review law as source of succesional right.

According to Art.1 Romanian State Aligement 3 of Title I General Principles of Romania's Constitution, Romania is a rule of law , democratic and social state, where human dignity, citizens rights and freedoms , free development of human personality, justice and political pluralism are supreme values.

According to Art.1 Romanian State Aligement 5 of Title I General Principles of Romania's Constitution, in Romania respect of Constitution, of its supremacy and laws supremacy are obligatory.

Principles of subsidiarity is resulting from Art.1 of European Convention concerning the acknowledging by Parties States for each person who is subject to their jurisdiction of rights and freedoms regulated by Convention.

These principles involve there are States who must first of all take measures on creation of framework of human rights and fundalemntal freedoms and of controle of these rights and freedoms respect by national public authorities.

European Court of Human Rights is exercising a subsidiary controle on taking and applying these measures on national level.

According to Art.11 International Law and National Law Aligement 1 of Title I General Principles of Romania's Constitution, Romanian state is obliged to execute exactly and with good faith his obligations corresponding to treatees to which is part in.

We consider the european controle is a corollary of national controle.

Controle on national level concerning respect of these rights is exercised by national courts, according to internal law.

Controle on european level concerning protection of these rights is exercised by European Court of Human Rights, corresponding to European Convention on Human Rights and Rules of Court from Strasbourg which incorporate the amendments made by the Plenary Court on April 2nd 2012 and entered into force on September 1st 2012.

In succesional right they have taken measures concerning regulating human rights which are connected with succesional matter.

The fundamental principles of civil law connected with the succesional matter are:

Principle of property involve the respect of it and this one is the most important real right of human beeing.

Principle of equality in front of law involve all the persons are peer subjects to the law.

The influence of European Convention on Human Rights upon Romanian succesional law relations by way of right to respect for private and family life

Art.8 of Convention is regulating right to respect for private and family life.This article must be corroborated with Art.12 of Convention and Art.14 of Convention.

The protection is concerning private life, family life, domicile and correspondence of right 's titular.

This right has a limit stipulated by Convention: the authorities implication is allowed only in specilally conditions expressly stipulated : the involvement must be regulated by law , the measures must be necessary in a democratic society for national security, public safety, economic country prosperity, order's defense and criminal offence's prevention, health and morality 's protection, or other persons rights and freedoms protection.

Right to respect for private and family life is a conditional right , not a intangible one.

The "private life" term is an european autonomous notion.Its sense is compelxe and is including the following:

First of all it is entering in that concept "physical and moral person's integrity"².

Secondly it is including "person's right to establish and to develop relations with his fellow creatures"³.

Its first component is personal life and the second one is social life, and both of them are lying in close connection.

They are adding a third component –right to a healthy environment.

There are right to private life and right to personal life which are interdependent with succesional matter, by person's right to identity.

This one is including the person's right to meet his or her ascendants, which is very important in ability to inherit and title to inheritance field.

Establishment of filiation is determining ability to inherit and title to inheritance of persons towards their ascendants and contestation of filiation is determining inability to inherit and lack of title to inheritance towards them.

The Convention does not define family life.

This notion is including personal connections between parents and their children, only biological connection between them being insufficient.

"Child's interest is primary important respecting all problems concerning children committing"⁴ in case of parents divorce or of special situations.

There are also subjects of Art.8 from Convention adopted children and adoptive parents.

In the Case Pini and Bertani and Manera and Atripaldi versus Romania, by Decision from June 22th 2004, European Court of Human Rights reminded that adoption relations are subjects to Art.8 from Convention and a legal and real adoption is protected by this text. This is a just and equitable opinion, which is permitting to respect equality between natural and adopted children.

In the Case Marckx versus Belgium, by Decision from June 13th 1979, European Court of Human Rights established that successions and liberalities field has a close connection with family life, which has a material component. This is the base created by case-law way, for the succesional matter to be subject of Art.8 of Convention.

In family life field, title to inheritance, ability to inherit and survivance right are subjects to Art.8 from Convention.

Art.957 Ability to Inherit from Title I General Disposals Concerning Inheritance from Book IV About Inheritance and Liberalities from New Civil Code is regulating in Alignment 1 ability to inherit. The person who exist on date of inheritance's opening death has the ability to inherit. The conceived unborn child has the right to inherit, with the single condition to born alive, not viable, according to Art.36 of New Civil Code. There is a difference between this rule and the similar rule of French Law, regulated by Art.725 The Qualities Requested to Inherit from Chapter II The Qualities Requested to Inherit: About Proof of Heir Quality from Title I The Inheritances from Book III About Different Ways to Acquire the Property from Civil Code, where there is other single condition- to born viable. Of course this condition to be born viable involves to be born alive, but the condition to be born alive does not involve to be born viable. We consider that the French Law is more rigorous than the Romanian Law. According to Alignment 2 the deceased persons whom moment of death we can not establish do not have the ability to inherit. By logical interpretation of this legal text, according to rule *Ubi lex non distinguit, nec nos distinguere debemus*, we consider there are also subjects of this article the commorients and the codeceased.

Art.962 Title to Inheritance from Title I General Disposals Concerning Inheritance from Book IV About Inheritance and Liberalities from New Civil Code is regulating title to inheritance. A person must have the quality requested by law or designation by legacy to inherit. This incidence is gathering way in legal inheritance field, but also in testamentary inheritance field, in case legatees are also defunct's relatives which have also legal title to inheritance and in case there are reservatory heirs and legatees are persons out of family.

Art.654 from Chapter I About Qualities Required to Inherit from Title I About Inheritances from Book III About Different Ways to Acquire the Property from Ancient Civil Code is regulating ability to inherit of persons who exist, including ability to inherit of unborn conceived child born alive and inability to inherit of persons who does not exist. There is no change of this rule.

"Family life has a close connection with succesional and liberalities between germane relatives field"⁵.

Art.986 Legacy from Section 1 from Chapter I Commun Disposals from Title III The Liberalities from Book IV About Inheritance and Liberalities from New Civil Code is defining the legacy: it is the liberality whereby the testator is disposing that to his death one or more legatees acquire all his patrimony, a part of it or some special goods. From this definition are resulting the unilateral, personal and *mortis causa* legacy characters, its beneficiaries and its object.

Art.802 About Donations and Wills from Chapter I from Book III About Different Ways to Acquire the Property from Ancient Civil Code is defining the will, as the revocable, *mortis causa* act

, whereby testator dispose on his patrimony or goods. From this definition are resulting revocable, unilateral and *mortis causa* will's characters and its object.

Successional reserve , excessive liberalities reduction and return of gifts and legacies are interdependent with family life .Reservatory heirs are always close relatives of defunct, from his founded family or his family of origin.Establishment of reserve , excessive liberalities reduction and return of gifts and legacies are in favour of reservatory heirs.

Art.1086 Notion of Successional Reserve from Section 1 Successional Reserve and Available Quota from Chapter IV Successional Reserve, Available Quota and Excessive Liberalities Reduction from Title III The Liberalities from Book IV About Inheritance and Liberalities from New Civil Code is defining the reserve.This is a direct definition.

Art.1089 Notion of Available Quota from Section 1 Successional Reserve and Available Quota from Chapter IV Successional Reserve, Available Quota and Excessive Liberalities Reduction from Title III The Liberalities from Book IV About Inheritance and Liberalities from New Civil Code is defining the available quota. This is also a direct definition.

The Ancient Civil Code did not define the reserve and the available quota , but only by doctrinary way we had the definitions, which are used in the New Civil Code.

Successional reserve , excessive liberalities reduction and return of gifts and legacies are all of them institutions that are protecting rights to inherit of reservatory heirs and respect of reserve constitution.

Art.841 and 843 from Ancient Civil Code amended by Law No.319 from 1944, Art.2 from Law No.319 from 1944 and Art.1087 from New Civil Code are regulating the same reservatory heirs: the survivor spouse, the descendants and the parents of defunct. They are all of them close members of decedent's family.

“Art.8 from Convention does not impose that a child have the right to a special part of his authors or close relatives inheritance”⁶.

Convention “is prohibiting discriminatory treatment between same person's children”⁷.

Whether if same person's children are resulted from the same marriage, from different marriages or outside of marriage , they have equal rights to their parents inheritance.

In this field children from natural filiation, resulted from marriage or outside of marriage, have the same equal rights as children from civil filiation, that means from adoption, who have been adopted by *de cuius*.

According to Art.448 from New Civil Code the children outside of marriage who have the filiation established according to law have the same equal rights towards their parents as the children resulted from marriage.

The situation was the same after Art.678 from Ancient Civil Code 's amendment by Art.63 from Family Code abrogated by Law No.71 from 2011.

The will may include disposals that in many cases , are concerning family life: legacies in favour of family members, , division, removal of former testamentary disposals, disinheritances, assignments to burden to members of family , disposals about obsequies, disposals concerning a child 's recognition.

Art.1035 Will's Content from Section 1 General Disposals from Chapter III The Will from Title III The Liberalities from Book IV About Inheritance and Liberalities from New Civil Code is stipulating the will 's content.The enumeration is sample, not restrictive.The principal testamentary disposal remains the legacy.

Art.802 from Ancient Civil Code was stipulating only the content of will which concerned defunct 's patrimony.

The agency of European Convention on Human Rights upon Romanian succesional law relations by way of protection of property

Protection of property is stipulated by Art.1 from Protocol No.1 to the Convention .

This article is comprising three norms:

The first norm is stipulating “general principle of respect of property right”⁸.It is instituting the correlative obligation of State not to disfranchise the property right titular of his right.

The second norm is instituting special limits to property right , which are “possibility to incapacitate the property right titular (...) of his right”⁹, but in certain conditions which are: in the

public interest and subject to the conditions provided for by law and by the general principles of international law. These conditions provided by Convention are cumulative.

The third norm is stipulating “the way to use goods which are the object of property right”¹⁰. This one is instituting other limits of property right, but these are conditions towards it according to the public interest or payment of taxes and duties or of other contributions too. These conditions are alternative.

The notion of “good” has “an autonomous sense”¹¹. *Lato sensu* it is comprising corporeal and incorporeal, movable and immovable goods, real rights, inclusive property right, usufruct right. We consider thereby it is comprising other dismemberments of property right, beside usufruct: use right, habitation right, which are rights with the similar legal nature as usufruct, superficies right and servitude right. This one is comprising right of possession, right of concession, full and by real principal and accessory rights. It is comprising claim rights and patrimonial intellectual creation rights too.

Connection between property field and successional matter is gathering way thereby:

In revendication and restitution of goods field which communist states made itself masters of them, claimants had asked for revendication and restitution in their quality of heirs of goods former owners and in case of admission of their requests, the courts established their quality of goods owners, as heirs of their authors.

In the Case *Brumărescu versus Romania*, by Decision from October 28th 1999, European Court of Human Rights established that acknowledged by justice and indefeasible property right can not be avoided. This opinion is in accordance with respect of juridical relations security and property right.

Intestate succession and legacy are some of the ways of acquisition of property right.

They are stipulated by Art.557 Alignment 1 of New Civil Code and Art.644 of Ancient Civil Code.

Intestate succession is an universal title or by universal title way of property right acquisition and testate succession is an universal title or by universal title or by particular title way of property right acquisition. Both of them are a derived and *mortis causa* and by gratuitous title way of property right acquisition.

The legacy object may be property rights, other real rights and claim rights.

There may be in the successional mass in the intestate succession and in the testate succession property rights, other real rights and claim rights too.

The agency of European Convention on Human Rights upon Romanian successional law relations by way of right to marry

Right to marry is regulated by Art.12 of Convention which is acknowledging right to marry and to found a family of men and women of marriageable age. This article must be corroborated with Art.8 and Art.14 of Convention. The Convention does not apparently limitate this right to marry, but in fact its limit exist by reference to national legislation. This is the one to stipulate marriage conditions. Convention is acknowledging two rights: to marry and to found a family. It is acknowledged only traditional marriage, because this right's titulars are man and woman, so different biological sex persons.

Only monogamous and civil, not religious marriage is subject of Art.12 of Convention, according to states parties tradition.

Marriage is producing effects in ability to inherit and title to inheritance field.

The survivor spouse has ability to inherit and title to inheritance, according to Art.970-971 from Section 1 The Survivor Spouse from Chapter III Legal Heirs from Title I General Disposals Concerning Inheritance from Book IV About Inheritance and Liberalities from New Civil Code and Art.1 and 2 from Law No.319/1944.

Art.12 of Convention is influencing concerning right to inheritance too.

The survivor spouse has ability to inherit and title to inheritance, according to Art.972 from Section 1 The Survivor Spouse from Chapter III Legal Heirs from Title I General Disposals Concerning Inheritance from New Civil Code and Art.1 and 2 from Law No.319/1944.

Art.12 of Convention is influencing concerning liberalities field too, the legatee may be the survivor spouse.

Art.12 of Convention 's agency exist both in intestate and testate succession.

In the Case Johnston and others versus Ireland, by Decision from October 28th 1999, European Court of Human Rights repeated that evolutive interpretation of Convention must be limited to rights stipulated by this text and must not create new rights which are not regulated by it. This praxis may maintain the balance between text and social and juridical relations evolution.

The agency of European Convention on Human Rights upon Romanian succesional law relations by way of equality between spouses

Equality between spouses is regulated by Art.5 from Protocol No.7 to Convention.

This is spouses right which is subject to civil rights and obligations field and exist in spouses relations and spouses and their children relations.

This right's titulars are consorts, so persons who have a marriage relation between them.

Equality exist on two levels: concerning consorts rights and obligations and their parental rights and obligations.

Art.5 from Protocol "is applied as additional text to Convention"¹² and must be corroborated with Art.8 and Art.12 of Convention.

This article is establishing superior interest of child which we consider an european and international principle.

In succesional matter there are ability to inherit and mutual title to inheritance of consorts and parents towards their children subjects to this text.

Liberalities matter is subject to this article too: spouses may legate by mutual wills one in favour to other or both of them in favour of a third person.

Art.1036 Mutual Will from Section 1 General Disposals from Chapter III The Will from Title III The Liberalities from Book IV About Inheritance and Liberalities is prohibiting mutual testamentary disposals or in favour of a third person in the same will of two or more testators. By logical interpretation by argument *per a contrario*, it is permitted for two or more person to legate by different personal individual wills mutually or in favour of a third person.

Both intestate and testate successions are subjects to Art.5 from Protocol.

In the Case Hoffman versus Austria, by Decision from June 23th 1993, European Court of Human Rights prohibited treatment inequality between spouses on ground of religious orientation of parents, which has a general and abstract character. This praxis is according to non-discrimination right.

The influence of European Convention on Human Rights upon Romanian succesional law relations in terms of general principle of prohibition of discrimination

Prohibition of discrimination is regulated by Art.14 of Convention. This one must be corroborated with Art.8 and Art.12 of Convention.

Prohibition of discrimination is an european and international principle.

This text is enumerating the grounds of persons discrimination: sex, race, colour, language, religion, political or other opinion, national or social origin, association with a national minority, property, birth or other status. The enumeration is for example, not a limiting one.

Non-discrimination "is a substantial (...) right"¹³.

Prohibition of discrimination is concerning rights and freedoms acknowledged by Convention.

Right to non-discrimination has a connection with succesional field in ability to inherit and title to inheritance matter, different heirs right to inherit, testamentary ability too, both in intestate and testate succession.

An important principle of Romanian Civil law is the equality before the civil law, according to Art.30 The Equality before the Civil Law from Title I General Disposals from Book I About Persons from New Civil Code.

In the Case Belgian Linguistic Affair, by Decision from July 23th 1968, European Court of Human Rights fixed that non-discrimination is connected by rights protected by Convention, it is not independent. This praxis is demonstrating that non-discrimination is general, but limited to the rights regulated by this text.

The relations between national law and european human rights protection law

According to Art.20 Alignment 1 from Chapter I Commun Disposals from Title II Rights, Fundamental Freedoms and Obligations from Constitution constitutional disposals concerning rights

and freedoms of citizens will be interpreted and applied in accordance to Universal Human Rights Declaration and conventions and treaties in whom Romania is part.

According to Art.20 Alignment 2 from Chapter I Common Dispositions from Title II Rights, Fundamental Freedoms and Obligations from Constitution in case of no accordance between conventions and treaties in whom Romania is part and national law, the international rules have priority, excepted the situation Constitution and national laws are more favourable.

According to Art.11 Alignment 2 from Chapter I Common Dispositions from Title I General Principles from Constitution treaties ratified by Parliament are sitting in internal law.

These dispositions of Art.20 and Art.11 of Constitution must be corroborated.

There are the same dispositions concerning Civil Code in Art.4 from Chapter I General Dispositions from Preliminary Title About Civil Law from New Civil Code.

There are the following important rules: there must be accordance between internal law and international law, the internal law must be interpreted and applied according to international law, but if the accordance does not exist, the international law has priority before the national law and the treaties ratified by Parliament are sitting in national law.

Res interpretata of European Court of Human Rights decisions

In the Case Dumitru Popescu versus Romania, from European Court of Human Rights Decision from April 4th 2007 is resulting the primordial role of national judge to take necessary measures for Convention's applying and its priority before the internal law and no applying the internal laws which are not in accordance with it. It is a principle of subsidiarity setting off.

The decisions pronounced by European Court of Human Rights have declarative character and "*res judicata*"¹⁴ between parties.

By way of *res judicata* they are producing effects only *inter partes*. But they also "have *res interpretata*"¹⁵.

By way of *res interpretata* they are producing effects *erga omnes*.

According to Art.1 of Convention The States parties are obliged to take "general measures to forbid in the future the repeating of infractions of the Convention"¹⁶.

Proposal of amendment to European Convention on Human Rights

By this way we are suggesting the amendment of European Convention on Human Rights by an Additional Protocol, which is regulating the right to inherit of persons, as a human and a civil right.

In case of deceased persons who had goods it is important to regulate their juridical situation.

By succession, *de cuius* patrimony is transmitted to their legal heirs, in the intestate succession or to the testamentary heirs, in the testate succession, or to the state in the vacant succession.

In practice, the problem that faced them it was the right to inherit and by case-law's way, European Convention on Human Rights acknowledged this right.

That is why we consider it is necessary the *expressis verbis* regulation of right to inherit on the level of European human rights law.

Conclusion

The influence of European Convention on Human Rights upon Romanian successional law is complex and evolutive. This is interdependent with European Human Rights Law development, Romanian Civil Law upsurge and European Court of Human Rights case law progress.

This influence is gathering way also in European and national legislative field and case law domain.

The context in whom the influence of European Convention on Human Rights upon Romanian successional law is gathering way is the constant development of protection of Human Rights in Europe.

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THE ROMANIAN LAWYER IN THE EUROPEAN LAW SYSTEM

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Abstract:

With Romania’s accession to the European Union, the practice of the legal profession has known a new dimension. Thus, since 1 January, 2007, Romanian lawyers can practice their profession, occasionally or permanently, in any of the European Union member states, as well as in states that are signatories to the Agreement on the European Economic Area. However, there is an increasing need for uniform and high-level training of lawyers in the European Union, in the context of developing the European integration process. This is mainly due to the very nature of the legal profession, which requires a very high level of competence in relation to the increasing complexity of social and economic relationships, as well as guaranteeing the protection of fundamental citizen rights. The rigorous and in-depth knowledge of national and European law norms, along with ethical correctness in the legal profession, are essential conditions for Bar Associations across Europe in the full implementation of fundamental rights, as recognized in the CCBE Charter regarding the legal profession.

Key Words: Lawyer, Romania, European Union, European Parliament, Charter of core principles of the European legal profession

Introduction

The historical perception on the legal profession, i.e. its independence from state authorities, has long been regarded as fundamental not only to the strict interest of the client, but also for society at large.

As regards the role played by lawyers in the modern organizational system of justice, it is viewed as essential. *“A lawyer must possess sound knowledge in matters of law, legislation and legal forms, but also a high moral authority, based on full independence and a genuine passion for truth and for justice”.*

The lawyer must be the first auxiliary of justice and the main collaborator of the judge, by studying the cases that are entrusted to him/her, by examining and re-establishing the facts under scrutiny, settling all matters of law related to those facts and serving the law with all the might of his talent.

“What any man of common sense must see is that, in a free society, a lawyer’s office, exercised by enlightened, honest and independent citizens, is as indispensable to the idea of justice as a magistrate’s, which is also suited for those who represent temperance, dignity and impartiality”.

The forerunners’ ideas have been reprised by our experts in the field of law, who found the lawyer’s mission to be that of defending a person’s property, honor, and freedom, which is why lawyers have enjoy great social standing and the highest of dignities in the state. *The lawyer’s mission is to represent or assist a person in justice or before administrative authorities, to lead and plead in trials as such, to give advice on legal situations.*

Issues currently raised in legal principle concern the optimization of the profession’s forms of organization, especially in this current situation, when the reform of the Romanian legal system must not be seen as having ended.

Main Text

Community Regulations

The community-level opening of the legal profession is governed by two specific directives, namely:

- Council Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of freedom to provide services;
- Directive 98/5/EC of 16 February 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained;

These two directives ensure normative support regarding the free circulation of services provided by lawyers in the European Union and allow the mutual recognition of community lawyers.

There are, however, other directives with important consequences on the exercise of the legal profession within the European Union, such as:

- Directive 2005/36/EC on the recognition of professional qualifications, which replaces Directive 89/48/EEC of 21 December 1988 on a general system for the recognition of higher-education diplomas awarded on completion of professional education and training of at least three years' duration, regarding the recognition of a lawyer's diploma in Romania;
- Council Directive 2002/8/EC of 27 January 2003 to improve access to justice in cross-border disputes by establishing minimum common rules relating to legal aid for such disputes;
- Directive 2008/52/EC of the European Parliament and of the Council of 21 May 2008 on certain aspects of mediation in civil and commercial matters;
- Directive 2006/123/EC of the *European* Parliament of 12 December 2006 on services in the internal market.

All these directives are developments of Article 43 of the EC Treaty, which governs the right of establishment, and of Article 49-55 of the EC Treaty, dedicated to the principle of freedom to provide services.

Theoretically, experts show, Romanian lawyers can provide services in any EU Member State, even if not all of them have implemented laws in this respect. Moreover, in the case where this cannot be achieved in practice, they may prevail before courts in that Member State by the direct effect of the directive, if the implementation deadline has expired (in this case the deadline was 1 January 2007) or if the implementation of the directive in that Member State is incomplete and/or incorrect.

Disjoining the lawyer's freedom of circulation, in relation to the primary provisions referring to the right of establishment and the freedom to provide services, we identify two possibilities to practice the profession:

1. occasional exercise of the legal profession in a Member State other than the state of origin;
2. permanent exercise of the legal profession in a member state.

Occasional (provisional) exercise of the legal profession in a Member State other than the Member State of origin.

If a Romanian lawyer should wish to provide, occasionally, for a certain client, legal services in another Member State of the European Union, s/he will be able to do so by using his/her professional title, expressed in the language of the state of origin, i.e. Romanian, by indicating the professional organization to which s/he is affiliated or the court in which s/he is allowed to practice his/her profession in applying the legislation of the Romanian state.

Council Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of the freedom to provide services institutes the principle of mutual recognition of licenses to exercise the legal profession, as the effective exercise of the legal profession entails that "*Member States must recognize as lawyers those persons practising the profession in the various Member States*" (paragraph 3 in the preamble to the directive), "*with the exception of any conditions requiring residence, or registration with a professional organization, in that State*" (art. 4 para. 1 last thesis of the directive).

Thus, the Romanian lawyer is allowed to provide occasional professional services in another Member State, utilizing the professional title in his/her home country, without needing the recognition of professional qualification or having to pass an examination in this respect.

However, as regards activities referring to the representation and defense of a client in court, each Member State has the possibility to require lawyers to meet the following conditions in order to exercise their profession:

- to be introduced, in accordance with local norms or customs, to the president of the jurisdiction and, as the case may be, to the competent dean in the host Member State;

– to collaborate either with a lawyer who practices law within that jurisdiction and who would be responsible, as the case may be, before that jurisdiction, or with an “*avoué*” or “*procuratore*” who practices law in this jurisdiction.

Likewise, the competent authority of the host Member State may require the service provider to make proof of being a lawyer in the Romanian state.

Permanent exercise of the legal profession in a Member State

A lawyer who has obtained the right to exercise this profession in Romania can also perform permanent activities in another Member State or in a country that is a party to the Agreement on the European Economic Area, thus:

- under the professional title in the Member State of origin;
- under the professional title corresponding to the legal profession in the host Member State, along with the professional title in the home country.

a. Exercise of the legal profession under the professional title in the Member State of origin, i.e. under the professional title obtained in Romania.

In principle, any lawyer has the right to permanently perform the same activities as those reserved to lawyers of the host country, under the professional title obtained in the Member State of origin. In this sense, unlike occasional exercise, the lawyer is obliged to register with the competent authority in that state, based on a certificate attesting his/her registration with the competent authority in the Member State of origin, i.e. Romania.

In order to avoid confusion with the professional title in the host Member State, the lawyer who practices his/her profession under the professional title obtained in Romania is obliged to do so under this title, which must be indicated in Romanian.

As regards the field of activity in which the lawyer may profess under the professional title in the Member State of origin, Directive 98/5/CE of 16 February 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member State other than that in which the qualification was obtained distinguishes two hypotheses:

- s/he may give legal advice, especially in matters of home Member State law, community law, international law and host Member State law;
- s/he may perform activities related to the representation and defense in court of a client, and inasmuch as the host Member State reserves these activities to lawyers professing under the professional title of that state, the former may require lawyers professing under professional titles in the Member States of origin to collaborate either with a lawyer professing within the court involved and which, when necessary, may be responsible before it, or with an “*avoué*”, who exercises his/her profession within that court. The same directive mentions ways to exercise this profession, provided for lawyers who use the professional title of their home country.

Thus, the lawyer who exercises his/her profession under the professional title obtained in Romania may opt for one of the following possibilities:

- perform independent activities;
- perform activities as an employee in the service of another lawyer, in an association or society of lawyers, or a public or private enterprise (inasmuch as the host Member State allows this for lawyers registered under the professional title used in that state);
- perform activities within a group.

Some specifications must be made regarding the ways to exercise the profession within a group. Thus, lawyers may perform activities under the professional title used in Romania:

- within a subsidiary or agency of their group in the host Member State (when there are incompatibilities between norms regulating that group in the Member State of origin and those in the host Member State, the latter are applied inasmuch as complying with them is justified by general interest, consisting of client and third-person protection);
- optionally, in a form of exercise of the profession within a group, among those that the host Member State also provides to its own lawyers (the ways in which these lawyers jointly perform activities in the host Member State are regulated by provisions laid down by law and administrative acts in that Member State).

Directive 98/5/EC of 16 February 1998 grants Member States freedom in adopting measures required to ensure the possibility of joint exercise of the profession by several lawyers from different

Member States who profess under the professional title in their Member States of origin, or by these lawyers and one or several lawyers in the host Member State.

b. Exercise of the legal profession under the professional title corresponding to the legal profession in the host Member State, along with the professional title in the home country

In order for a lawyer to integrate the legal profession in the host Member State, i.e. to be able to perform activities under the professional title corresponding to the legal profession in the host Member State, the provisions of art. 10 of Directive 98/5/CE of 16 February 1998 institute the following possibilities:

- lawyers who profess under the professional title of the Member State of origin shall make proof of having performed effective and regular activities for at least three years in the host Member State, in the field of law of that State, including community law (excepted from the fulfillment of conditions provided in article 4 paragraph (1) letter (b) of Directive 89/48/EEC, i.e. internship or skills testing);

- lawyers who profess under the professional title of the Member State of origin and who have performed effective and regular professional activities in the host Member State for at least three years, but for a shorter period in the field of law of that Member State, may obtain, from the competent authority in the host Member State, admission to the legal profession in the host Member State and the right to practice it under the professional title corresponding to the profession in that Member State, without being obliged to fulfill the conditions provided in Article 4 paragraph (1) letter (b) in Directive 89/48/EEC (the effectively performed activity and the ability to continue the activity performed in that state shall be evaluated based on an interview).

- lawyers who profess under the professional title of the Member State of origin in a host Member State may, at any time, require their diplomas to be recognized in accordance with Directive 89/48/EEC, for the purpose of obtaining admission to the legal profession in the host Member State and exercise it under the professional title corresponding to the profession in that Member State (entails the fulfillment of conditions in Article 4 paragraph (1) letter (b) of Directive 89/48/CEE, i.e. internship or skills testing).

Lawyers admitted to the legal profession in the host Member State in one of the above-mentioned ways has the right to use, in addition to the professional title corresponding to the legal profession in the host Member State, the professional title in his/her home country, expressed in the official language or in one of the official languages of the Member State of origin.

It can be seen that, in the first two situations, to integrate the legal profession in the host Member State, the lawyer leverages the period in which s/he performs activities in the host Member State, under the professional title in the home country, followed by taking a skills test.

As regards the third variant, a consequence of the abrogation of Directive 89/48/EEC, effective since 20 October 2007, references to this directive shall be read as references to Directive 2005/36/EC on the recognition of professional qualifications.

Similarly to Directive 89/48/EEC, this directive stipulates, under the title “*compensation measures*” (art. 14), the right of the host Member State to require the applicant to pursue an adaptation internship of up to three years, or to undergo skills testing in one of the following cases:

- the duration of training, as evidenced under Article 13 paragraph (1) or (2), is shorter by at least one year than that required by the host Member State;

- the training received by the applicant covers subjects that are significantly different from those covered in the qualification required by the host Member State;

- the profession regulated in the host Member State comprises one or several regulated professional activities that do not exist in the corresponding profession in the applicant’s home Member State, in the sense of Article 4 paragraph (2), and this difference is characterized by special training that is required in the host Member State and which covers subjects that are significantly different from those covered by the applicant’s skill certificate or qualification.

As the exercise of the legal profession requires exact knowledge of national law and essentially and constantly entails the provision of counseling and/or assistance on national law, the host Member State, by exemption from the general principle that the applicant has the right to choose, may require either an adaptation internship, or a skills test. A very important element lies in the provisions of Art. 15 of Directive 2005/36/EC, which stipulates the possibility to renounce the rights of compensation based on a common platform, i.e. an ensemble of criteria pertaining to professional

qualifications, likely to compensate for the significant differences found among the training requirements of the various Member States for a certain profession. Common platforms may be presented to the Commission by Member States or by representative professional associations or organizations, at national and European level.

Consequently, these “common platforms” between homologous professionals in Member States may substitute rules of the general directive, in order to “relax” the general framework of the directive on the recognition of professional qualifications.

Thus, as stated in ECJ practice (case *Christine Morgenbesser vs. Consiglio dell’Ordine degli avvocati di Genova* (C-313/01)) and the European Parliament’s Committee on Petitions (Petition 192/2004), Directive 98/5/EC applies exclusively to fully qualified (definitive) lawyers, whose qualifications are listed in Article 1 of the Directive.

It follows that any applicant who would either require the recognition of his/her qualifications as a lawyer, based on Directive 2005/36/EC, in a Member State (with the permission to exercise his/her professional qualification in the host Member State after receiving recognition), or who wishes to immediately exercise the legal profession in a host Member State, using his/her professional qualification in the Member State of origin, in accordance with Directive 98/5/EC, must be already recognized as a definitive lawyer in the Member State of origin.

Common principles

The principle of national treatment. This principle obliges Member States of the European Community to give lawyers from another Member States the same treatment as given to their own lawyers. A few exceptions are permitted in matters of performing activities concerning the representation and defense in court of a client.

Compliance with the deontology of the host Member State and the obligations of the home Member State. As a general rule, the lawyer who practices his/her profession, either occasionally or permanently, in a Member State other than that in which s/he obtained professional qualification, must comply with professional and deontological rules applicable to lawyers who profess under the corresponding professional title in the host Member State for activities performed on the territory of that State. Likewise, the lawyer, being registered with the competent authority in the home country, will have to comply with the obligations incumbent on him/her in this quality.

Collaboration of competent authorities. The liberalization of the exercise of the legal profession beyond the borders of one’s home country entails a close collaboration among the competent authorities of Member States, indispensable for ensuring the proper application of above-mentioned community provisions, especially as part of disciplinary procedures.

Application of competition law to the legal profession. Community norms and ECJ practice converge in the sense that liberal work, including work performed by lawyers, is an economic activity, similar to the work performed by a commercial company. Thus, in the case *Klaus Höfner and Fritz Elser vs. Macrotron GmbH* (C-41/90), ECJ extensively defined the concept of enterprise (commercial company), stipulating that, in the context of competition law, the concept of enterprise (commercial company) comprises all entities that run economic activities, regardless of legal status and financing sources.

Consequently, rules of competition law also apply to the legal profession, albeit distinguished from trading activities in that the legal profession contributes to general interest.

A fundamental Directive, with important consequences on liberal professions, is Directive 2006/123/EC of the European Parliament on services on the internal market, which applies subsidiarily to the legal profession with regard to aspects that are not covered in sectoral Directives.

The Directive establishes general provisions to facilitate the exercise of the freedom of establishment for service providers and the free circulation of services, while maintaining a high level of service quality. Its application to the legal profession has been contested, proposing the exclusion of the exercise thereof from the scope of the Directive.

The Directive aims to simplify procedures and formalities required for access to a service-providing activity and its exercise. In this sense, incident upon the matter of Bar registration are provisions concerning the establishment of the single-point institution and the use of electronic means.

We mention that the principle established by this directive, that Member States should accept any document of another Member State (certificate, attestation etc.) proving compliance with

requirements by a service provider or recipient, does not apply to documents listed in Article 3 paragraph (2) of Directive 98/5/EC (certificate attesting the lawyer's registration with the competent authority in the Member State of origin, based on which the competent authority in the host Member State registers the lawyer).

The Directive establishes the freedom to provide services and related principles, but shows that these do not apply to fields regulated by Council Directive 77/249/EEC of 22 March 1977 to facilitate the effective exercise by lawyers of the freedom to provide services.

The Directive is also incident upon the rules regarding publicity, art. 24 para. 1 thereof stating that "*Member States shall remove all total prohibitions on commercial communications by the regulated professions*".

Another aspect concerns the harmonization of professional deontology, encouraging the development of "*codes of conduct at Community level, aimed, in particular, at promoting the quality of services and taking into account the specific nature of each profession.*"

Those codes of conduct should comply with Community law, especially competition law". As such, the Directive confirms assimilation with commercial activities, established by EJC jurisprudence, making reference to competition law.

Major changes on the world market require a pertinent response of the profession to political and commercial pressures on fundamental values.

This "confrontation" also requires the "re-evaluation of the lawyer's institutional position both in relation to the judicial power and, especially, in relation to the business environment and civil society, in a world where the need to ensure legal and judicial security through professional legal services, provided independently, with the authority and competence demanded by the rule of law" cannot be contested.

As remarked, on several occasions, by the European Commission and the Council of Bars and Law Societies in Europe (CCBE), there is an ever-growing need for uniform and high-level training of lawyers in the European Union, in the context of development of the European integration process. This is mainly due to the very nature of the legal profession, which requires a very high level of competence in relation to the increasing complexity of social and economic relations, and in order to guarantee the protection of fundamental citizen rights.

The rigorous and profound knowledge of national and European norms of law, as well as ethical correctness in the legal profession, are essential requirements for Bar Associations in Europe to fully implement fundamental rights recognized in the CCBE Charter on the legal profession. These principles, while adopted slightly differently by national legislations, are common principles for all EU lawyers.

Thus, the European Commission set the target of training 700,000 law professionals in European Union law until 2020. The Commission intends to make available, for half of all European law practitioners (700,000 people), the training means required for applying Union law, a specific prerogative for functions exercised by judges, lawyers and other jurists, at national level. This measure will also contribute to reciprocal confidence among the various law systems in the European Union and will improve the application of European legislation. We believe this measure to be beneficial for citizens and enterprises in Europe, which will then be able to rely on rapid decisions and a veritable respect for rules.

Likewise, the EC decided that law practitioners should benefit from at least one week of training in Union law at any stage in their career.

In order to attain this objective, the Commission invited national governments, high councils of magistrature, professional bodies and training institutes, at both European and national level, to engage in integrating Union law into their training programmes and to increase the number of courses and participants.

The Commission itself undertakes to facilitate access to Union funding for high-quality training projects, including e-learning.

In virtue of its new multi-annual financial framework, the Union aims to prioritize European training for an annual number of around 20,000 law practitioners, until 2020.

European training is susceptible to take place during either initial or lifelong training, with two fundamental elements:

- Union legislation, in both material and procedural law, as well as the corresponding jurisprudence of the European Court of Justice;
- knowledge of national law systems.

These courses may be accompanied by language training. The European judicial training programme comprises two additional elements: European judicial training programmes, in general, and cross-border exchanges.

Conclusion

From the above-stated we may conclude that these are very interesting times for lawyers, with many changes at European Union level. It is a delicate exercise to find the correct balance in the lifelong and unitary training of lawyers.

We believe that the lifelong training of lawyers not only responds to the need to promote the development of the legal profession in Europe and to protect intellectual and moral prestige, but that it also represents the fulfillment of a task of the legal profession in society.

An adequate judicial training would largely contribute to the improvement of the internal market and would facilitate the exercise of rights by citizens.

Training is essential for a modern, well-functioning justice system, able to reduce high risks and costs that can stall economic growth.

Training is, henceforth, an indispensable investment for establishing justice in the service of growth.

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RETHINKING RUSSIAN MISSION IN SYRIA

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Abstract:

Since the collapse of the USSR, Syria has remained to be center of Russian Middle East foreign policy regarding its economic and political ties. As a result of the Arab Spring, the Syrian regime and President Assad has shaken with the unrestrained uprisings and western sanctions and eventually crisis turned into a fierce civil war. From the inauguration of the crisis Russia has never altered its political view on Syria even though there were expectations to the contrary. Moscow officially remained calling for “No military intervention against Syria” and that’s why three times vetoed US resolutions concerning widening sanctions or allowing multilateral military operations. However, Russia claims that Moscow is not protective of Syrian regime or Assad instead prevents Syria to fall into a long-term civil war. On the other hand, Syria is one of the most crucial arms importer of Russia and hosting Russian naval base on its Mediterranean coast. In this paper it is aimed to analyze the Russian stable and consistent foreign policy on Syria and its reasons as well as latest Russian and US rising tensions.

Key Words: Russian foreign policy, Syria, Middle East, Multipolarity

Introduction

Since the collapse of the USSR, Russia paid attention not only on the former Soviet Union Republics and its diaspora, the Middle East has remained of substantial interest in Moscow. Russia has the largest Muslim population in Europe and wants to have good relations with the Islamic world.¹²⁷ Meanwhile for a long time Syria has remained one of the most independent countries from the West, particularly the US and has had close relations with Russia which was established during the Soviet Union. During the Cold War as a result of close relationship many Russians moved to Syria – intermarriages- and in return, many Syrian elites studied at top Russian schools such as Moscow State University and People’s Friendship University.”¹²⁸ Following the dissolution of the USSR, Chechen issue has emerged twice as a fundamentalist and a separatist movement in the southern border of Russia.¹²⁹ Thus, unremitting close relations with Islam world is crucial for Russia due to prevent the financial and political support for these fundamentalist Islamic movements in Russia as a whole.¹³⁰

Ever since the beginning of the Syrian crisis, Russia and the rest of the Western world has encountered many times in the international arena. Despite the fact that Russia has never changed its position from the beginning, the statements of Russian officials were occasionally acknowledged as compromising step, Moscow committed itself calling for single strategy: “No military intervention against Syria”. Russian Foreign Minister Lavrov has pointed out that Russia had many questions after the UN Security Council adopted the Libyan resolution which allowed military intervention to protect civilian lives and turned into Libya chaotic. Consequently Lavrov has described Russia’s position in the Syrian case as; “We are not protecting any regime” and opposed a Libya-style military

¹²⁷ Kreutz, Andrej, “Syria: Russia’s Best Asset in the Middle East”, IFRI/NIS Center, Russie.Nei.Visions., No.55, November, p.5.

¹²⁸ Barshchevskaya, Anna, “Russia’s Many Interest in Syria”, Policy Watch 2023, 24 January 2013, p.1.

¹²⁹ Kreutz, *ibid*, p.5.

¹³⁰ Sharp, Jeremy, and Blanchard, Christopher M., “Armed Conflict in Syria: US and International Regime”, CRS RL33487, 21 August 2012, p.7; “In early 2012, US officials stated that the violence and disorder paralyzing Syria was creating opportunities for Al Qaeda operatives and other violent Islamist extremists to infiltrate the country and conduct or plan attack.”

intervention against the Syrian regime.¹³¹ Syria was the most consistently pro-Soviet state in the Middle East until the mid 1990s and in the meantime it seems that still contains specialty for the Russian Federation.

Main Pillars of Russian Foreign Policy Towards Syria

Afterwards Yeltsin inherited cold relations between Damascus and Moscow from the Gorbachev era and revived the close relationship that existed under Brezhnev. Russia always has separated its bilateral relations in the Middle East are regarding Israel and others. For instance Gorbachev refused to support Syria's objective of achieving strategic party with Israel did not mean that Moscow was prepared to abandon its interests in the Middle East altogether. For this reason, the USSR continued to supply air defense systems to Syria.¹³² Moreover in 1994 when Russian Federation was troubled with the transformation of its economy, Kremlin postponed Syria's 10 billion \$ debt and proposed import by some Syrian goods instead of paying.¹³³ Starting from 1998 Russia began to play more active role in the Middle East peace process. Primakov, then Russian Foreign Minister, remained pragmatic concerning the Israel and its neighbors.¹³⁴

By coincidence, long time Syrian leader Hafez al-Assad died in the middle of 2000, during the first year of Putin's presidency and Vladimir Putin telephoned the new Syrian leader Bashar-al-Ashad, son of Hafez al-Assad and commemorated his father as "one of the most outstanding and distinguished leaders in the modern world", and "a friend of Russia who did so much for the development of Russian-Syrian cooperation."¹³⁵ At this point Kreutz describes Putin's Syria foreign policy as "preserving and if possible expanding Russian-Syrian relations in order to maintain positive aspects of previous Moscow-Middle Eastern involvement, and to promote Russia's image as a country friendly toward Islamic peoples".¹³⁶ In terms of economic ties, Syria is one of the significant market for Russia's arms sales and also shortly before the Syrian crisis, Gazprom prepared for the leading role in Syria's oil and gas industry.¹³⁷ Hence if Assad regime falls, Russia might lose its contracts as its was happened in Iraq and Libya before. Furthermore, former Russian President Medvedev made a noteworthy visit to Syria in May 2010 and also met with Hamas leader Khalid Mashaal. During the visit of President Medvedev, he stated that Hamas should be included in the Middle East process despite Israel's opposition to the Islamist movement and displayed Russian involvement in the Middle East crisis.¹³⁸

Subsequently in the midst of the Arab Spring, starting from 2010, the uprising began to organize in some towns of Syria against the Assad regime. When protests reached Syria in March 2011, in the southern town of Deroa, the protesters called on Assad to reform not resign.¹³⁹ Nevertheless two years passed and unlike the Libyan, Egyptian or Tunisian case, the Syrian regime is still able to pay its military and civilian staff and it has also enough currency reserves¹⁴⁰ as well as an affiliation of Russian and Iranian aids. At the beginning of the Syrian crisis, the US and EU have bolstered unilateral sanctions and tried to pass resolutions to deepen international pressures and have openly called for President Assad to step aside.¹⁴¹ Moreover a multilateral intervention either led by NATO or by an Anglo-French-American-Turkish coalition appeared as an only solution¹⁴² whereby Russia highly opposed to this option.

¹³¹ Middle East Online, "Russia Will Not Allow Libya-Style Military Intervention in Syria", 1 November 2011, <http://www.middle-east-online.com/english/?id=48833>

¹³² Nizameddin, Tala, "Russia and the Middle East", C.Hurst & Co.Pub., 1999, p.160.

¹³³ Ibid, p.161.

¹³⁴ Ginat, Rami, "Syria and the Doctrine of Arab Naitonalism: From Independence to Dependence", Sussex Academic Press, 2010, p.232.

¹³⁵ Kreutz, Andrej, "Russia in the Middle East: Friend or Foe?", Greenwood Pub. Group, 2007, p.25.

¹³⁶ Ibid, p.25.

¹³⁷ Barshchevskaya, ibid, p.2; "According to the Stockholm International Peace Resrearch Institute, Russia accounted for 78% of Syria's wepoans puschases between 2007-2012...Beyond weaponry, Russian companies have invested \$20 billion in Syria since 2009 according to the Moscow Times."

¹³⁸ Rawshandil, Jalil and Lean, Nathan Chapman, "Iran, Israel, and the US: Regime Security Vs. Political Legitimacy", ABC-CLIO, 2011, p.76.

¹³⁹ Phillips, Christopher, "Syria's Bloody Arab Spring", LSE IDEAS Special Report, May 2012, p.37.

¹⁴⁰ Chatham House, "The Political Outlook For Syria", MENA Programme: Meeting Sumamry, January 2012, p.4.

¹⁴¹ Nerguizian, Aram, "Instability in Syria: Assessing the Risk of Military Intervention", CSIS, 13 December 2011, p.ii.

¹⁴² Weiss, Micheal, "Safe Area For Syria: An Assessment of Legality, Logistics and Hazards", Strategic Research & Communication Centre, Transitional Period Policy Research, 2011, p.7.

Syria is Russia's last remaining robust Arab ally in the Middle East and Syria is hosting a Russian naval base that is located Syrian Mediterranean coast Tartus constructed in 1971. Russia's naval presence in Tartus might have three aims: Russian support for Assad; score of NATO or Western powers with encirclement of a regional ally; and a message of any campaign would return Western-Russian relations to Cold War lows.¹⁴³ Despite the central role that Syria played in Russia's foreign policy, Kremlin mostly concentrated on diplomacy instead of the use of force. Hence Russia provides Assad a diplomatic umbrella in the UN, protecting it from resolutions and preventing a possible international intervention.¹⁴⁴ Additionally in order to prevent fall of the Assad regime, Russia, together with China, vetoed three times –October 2011, February 2012 and July 2012- UN Security Council resolutions targeting multinational military intervention against Syria.¹⁴⁵ Although Russia has refused to back any UN Security Council resolution threatening sanctions or military force against the Assad regime, Moscow has supported a UN-led process to establish a political and diplomatic solution in Syria and received visiting representatives of Syrian opposition delegates over the two years.¹⁴⁶ In addition to that Russia worries that a post-Assad Syria will be dominated by Islamists, who would encourage Islamist movements in southern regions of Russia.¹⁴⁷ Currently on the one hand, Iran¹⁴⁸ and Russia actively support the Assad regime and provide aid; on the other hand, the US, Europe, regional countries such as Turkey and Qatar provides aid to opposition groups in Syria.¹⁴⁹

In the middle of the 2012 the hopes of falling of Assad began to drop off because it was connoted that the regime will survive in the long-term and will fight for it. Despite opposition in Syria receives financial and arms aid, the Assad regime has the advantage of military capability and may be able to fight for a couple of years more unless there is a massive uprising in Damascus and Aleppo, or an intervention. Notwithstanding Russian support for the Syrian existing regime has been an obstacle to international action.¹⁵⁰ For this reason some claims that Russia should be persuaded that continuing support of the Assad regime is dangerous for Russia due to reason of collapse of the regime and create a political vacuum in Syria that would not serve Russia's foreign policy interests at all.¹⁵¹ In other words, Russia's objections to regime change in third countries such as Syria are rooted not only in principles of state sovereignty and noninterference but also about what happens after the fall of the regime.¹⁵²

Is Russia Giving Up on Syria?

For Moscow, Syria events portrayals different meanings than Tunisia, Libya or Egypt due to reason of Damascus close relationship with Moscow in last six decades. Both countries have depth historical relations and mutual benefits which are important in terms of continuity and durability. Therefore Syria has been considered as an ally of Moscow in the Middle East since the days of the Cold War and in return until the collapse of the USSR, Damascus had kept its loyalty to Moscow. After the recovery of administration in Moscow with by Putin's authoritarian presidency, Russia's primary connection option was again Syria among the other Middle Eastern countries. The place of the Middle East in the foreign policy of the Kremlin had remained similarly even during the President Medvedev and then the same approach continues with the coming of President Putin for the third time. When we look at the importance of Syria in Moscow detailed:

¹⁴³ Ibid.

¹⁴⁴ Geifman, Anna and Teper, Yuri, "Russia's Declining Influence in the Middle East", BESA Center Perspectives, Paper No.194, 24 December 2012, p.2.

¹⁴⁵ Committri, Camilla, "When Domestic Factors Prevail Uoqn Foreign Ambitions: Russia's Strategic Game in Syria", IAI Working Papers 12, 16 October 2012, p.7.

¹⁴⁶ IISS Strategic Comments, "Russia's Syrian Stance: Principles Self-Interest", Vol.18, Comment 31, September 2012, p.1.

¹⁴⁷ Byman, D., Doran, M., Pollak, K., and Shaikh, S., "Saving Syria: Assessing Options For Regime Change", Brookings Institute, MEMO No.21, March 2012, p.3.

¹⁴⁸ Clawson, Patrick, "Post-Assad Syria: Opportunity or Quagmine?", Naitonal Defense university, Strategic Forum, SF No.276, Febuary 2012, p.6.

¹⁴⁹ Byman, Doran, Pollak, and Shaikh, *ibid*, p.5.

¹⁵⁰ Chatham House, "The Political Outlook For Syria", MENA Programme: Meeting Sumamry, January 2012, p.2.

¹⁵¹ Bellin, Eva and Krause, Peter, "Intervetnion in Syria: Reconciling Moral Premises and Realistic Outcomes", Brandeis University, Middle East Brief No.64, June 2012, p.5.

¹⁵² Trenin, Dmitri, "The Mythical Alliance: Russia's Syria Policy", The Carnegie Papers, February 2013, p.6.

- Russia's Syria policy is linked with that Syria that is positioned in the strategic heart of the Middle East, and that Moscow's links to the Assad family go back to four decades.¹⁵³
- Russia has a commercial supremacy in the region in terms of arms trade and in consequence Moscow does not want to lose this supremacy. Syria is among the largest purchasers of Russian weapons and currently two countries have ongoing contracts that amount of \$3.5 billion.¹⁵⁴ Alternatively foreign arms supplies to the Syrian regime of President Bashar al-Assad had increased dramatically over the period 2007-2011, compared to the five previous years. In March 2012 the SIPRI report indicated that Syria's imports of major weapons were increased by 580% between 2002 to 2006 and 2007 to 2011 which 78% of arms were Russian supply.¹⁵⁵
- In the post- Cold War era Russia commenced to follow a new concept of foreign policy which is called "multipolar world order" policy in order to regain a global power status and balance US unipolar actions mostly by diplomatic efforts. Russia was opposed both the Iraqi war and also military intervention in Libya and made efforts to prevent US military operations in the region by perpetrating diplomatic tools in international organizations. In this sense preventing a foreign military intervention in Syria by diplomatic efforts serves for Russian multipolar foreign policy approach.
- Another reason is a population of Circassians that are living in Syria who still hold direct ties to their relatives in the Northern Caucasus. Syria is home to approximately 150,000 Circassians about half of whom live in Hama province who retain their linguistic characters from Adyge in the Northern Caucasus. The Circassians are considered as a warrior class and participated in many Syrian military campaigns and police actions over the decades. They are secular and supporters of the Assad regime and generally before the outbreak of violence in Syria, fared well with the other faiths found in the country.¹⁵⁶ Consequently the security of Circassians in the region has crucial importance for Russia. In this respect, the main problem for the Circassians in Syria is post-Assad era.
- After the "color revolutions" in the former Soviet region, Russia was alarmed that Moscow was losing its influence area and/or revolutions were spreading in Russia. From the Moscow point of view Arab Spring events were similar to "color revolutions" in 2005-2006 and incited by foreign forces instead of local society. Therefore Russia took the position in support of the status quo in order to prevent civil wars."¹⁵⁷
- Finally Russia focused on its fight against Islamists in its southern underbelly in Chechnya and Dagestan, also worries that a post-Assad Syria will be dominated by Islamists, who would be hostile to Moscow.¹⁵⁸ Hence according to the UN Refugee Agency that "Chechens Are Among Foreigners Fighting to Overthrow Bashar al-Assad". In addition according to an AFP source in Riyadh, there are at least 6,000 foreign militants fighting in Syria, under the flag of al-Qaeda. The most important point is most of the fighters comes from some Arab countries but there are also some from Chechnya.¹⁵⁹

¹⁵³ Trenin, Dmitri, "Why Russia Supports Assad", Carnegie Endowment, 9 February 2012, <http://carnegieendowment.org/2012/02/09/why-russia-supports-assad/9j2x>

¹⁵⁴ St. Petersburg Times, "Lavrov In Syria To Strongly Back Assad", 10 February 2012, Issue 1964, http://www.sptimes.ru/index.php?story_id=35142&action_id=2

¹⁵⁵ Parfitt, Tom, "Syria: Dramatic Increase Reported In Foreign Arms Supplies to Assad Regime Between 2007-2011," The Telegraph, 19 March 2012,

<http://www.telegraph.co.uk/news/worldnews/middleeast/syria/9153514/Syria-dramatic-increase-reported-in-foreign-arms-supplies-to-Assad-regime-between-2007-2011.html>

¹⁵⁶ Karasik, Theodore, "Explaining Russia's Policy Towards Syria", Eurasia Review, 9 December 2012, <http://www.eurasiareview.com/09122011-explaining-russias-policy-towards-syria-analysis/>

¹⁵⁷ Trenin, Dmitri, "Why Russia Supports Assad", Carnegie Endowment, 9 February 2012, <http://carnegieendowment.org/2012/02/09/why-russia-supports-assad/9j2x>

¹⁵⁸ Byman, D., Doran, M., Pollak, K., and Shaikh, S., *ibid*, p.3

¹⁵⁹ Fernandez, Yusuf, "Is the Syrian conflict a danger for Northern Caucasus?", Press TV, 8 January 2013,

<http://www.presstv.ir/detail/2013/01/07/282288/syria-militants-endanger-russia-security/>, Vatchagaev, Mairbek, "Chechens Are Among Foreigners Fighting to Overthrow Bashar al-Assad", Eurasia Daily Monitor, VOL.9, Issue 219, 30 November 2012,

http://www.jamestown.org/single/?no_cache=1&tx_ttnews%5Bttnews%5D=40185&tx_ttnews%5BbackPid%5D=7&cHash=3d9a50dff6161d2dbbc6f101bf94d5db

After Houla events on May 25th, 2012 in which 108 persons were killed, the US hoped that it would be a “turning point” in Russia’s reluctance to act against ambiguity of Syria. Despite the fact that Kremlin supported a UN Security Council resolution condemning Syria for using artillery in the massacre in Houla but this was most probably because Russia did not want to be seen as defending an atrocity.¹⁶⁰ Based on Russian experience in Chechnya and Beslan, Kremlin strongly believes that radical Islamists and outraged rebels, including Al-Qaeda militants, are more capable of carrying out such atrocities than the regimes’s security services or the army.¹⁶¹

Russia is giving an important examination to become a global power in Syria Crisis. In this context, while the Kremlin supports the Assad regime in Syria, ideally it looks like Russia is against the West and policy of West. Meanwhile, Russia aims to protect its own interests in Syria by conducting talks with the key actors for the post-Assad period. For instance Mordechai Kedar who has connection with Russia pointed out that the division of Syria is necessary including 14 administrative districts that reflect the demographic distribution of the population.¹⁶² According to Kedar the partition of Syria can only be completed by a historic alliance with Russia and Syria. Another important point is the Russian naval existence in the Mediterranean Sea by the way Tartus naval base in Syria. For this reason, Russia wants to use every opportunity about the Syrian crisis in order to keep its both diplomatic, economic and military existence. Thus Russia negotiates with opposition members (the National Coalition for Syrian Revolutionary and Opposition Forces) and calls for an agreement between the opposition groups and Assad regime.¹⁶³ Consequently Russia spearheads the idea that the Syrian people must be allowed to choose their destiny without foreign pressure or interference which means “Syria's future belongs to its people”.¹⁶⁴

Analysis of Four Months In Order to Understand Russian Foreign Policy

October 2012: On the night of the 10th of October on suspicion of carrying military cargo, Turkey forced to land a civilian aircraft to Esenboga Airport in Ankara –capital city of Turkey- by the force of the military jets, which was flying from Moscow to Damascus. In Russia it was averred that the passengers on board of the aircraft were forced to sign a paper to say that “the aircraft wasn't landed by Turkish warplanes but did an emergency landing” and it was also claimed that four passengers were beaten.¹⁶⁵ Furthermore Russia asserted that the cargoes of the aircraft which were seized during the search of Turkish teams were not weapons, rocket and similar munitions. It was stated in the Russian Kommersant Newspaper that technical devices carried on the plane were taken for the anti-aircraft radar system, belonging to the armed forces of Syria and they had no need for a special report.¹⁶⁶ As a result, albeit relations were stressed because of the aircraft crisis, Russian Foreign Minister Lavrov reduced the strenuous tension and made a statement that “Syrian aircraft which was landed in Ankara that Turkey in this case behaved according to Chicago Convention.”¹⁶⁷

¹⁶⁰ Satter, David, “Russia and Syria”, Foreign Policy Research Institute, E-notes, June 2012, <http://www.fpri.org/articles/2012/06/russia-and-syria>

¹⁶¹ Kozhanov, Nikolay, “Russia’s Response to the Massacres in Syria”, Policy Watch 1951, 13 June 2012, p.2.

¹⁶² Kedar, Mordechai, “Mordechai Kedar: The Division of Syria”, The Jewish Press, 21 February 2012, <http://www.jewishpress.com/indepth/analysis/dr-mordechai-keidar/mordechai-keidar-the-division-of-syria/2012/02/21/>

¹⁶³ INTERFAX, “Russia Confirms It Wants Regular Contacts With Syria Opposition Coalition”, 2 February 2013, <http://www.interfax.com/newsinf.asp?id=392977>, Barry, Ellen and Fahim, Kareem, “Russia Calls for Meeting With Syrian Opposition”, New York Times, 28 December 2012, <http://www.nytimes.com/2012/12/29/world/europe/russia-urges-assad-to-negotiate-with-his-opponents.html>, 28.1.2012, Al-Arabiya, “Russia 'Actively' Persuading Assad Regime to Talk to Opposition: Lavrov,” 28 December 2012, <http://english.alarabiya.net/articles/2012/12/28/257452.html>

¹⁶⁴ RIA NOVOSTI, “Russia Rules Out Libyan Scenario in Syria”, 9 December 2012, <http://en.rian.ru/russia/20121209/178024186.html>, RT, “Syria's Future Belongs to Its People - Russian Premier”, 6 November 2012, <http://rt.com/politics/syria-russia-medvedev-conflict-047/>

¹⁶⁵ RT, “Turks Force Syrian Crew to Sign 'Emergency Landing, No F-16s' Statement –Witnesses, 11 October 2012, <http://rt.com/news/plane-passenger-reaction-140/>, INTERFAX, “Moscow Demands Turkish Explanations of Incident With Syrian Plane Carrying Russians”, 11 October 2012, <http://www.interfax.com/newsinf.asp?pg=6&id=367227>, RT, “Syria Accuses Turkey of 'Air Piracy', Demands Return of Seized Cargo”, 12 October 2012, <http://rt.com/news/syria-accuse-turkey-cargo-195/>

¹⁶⁶ RIA NOVOSTI, “Russian Press at a Glance, Friday, October 12, 2012”, <http://en.rian.ru/papers/20121012/176570910.html>

¹⁶⁷ Cumhuriyet, “Rusya: Türkiye'nin Buna Hakkı Var”, 25 October 2012, <http://www.cumhuriyet.com.tr/?hn=371772>

November 2012: After the meeting in Cairo about Syria with Lakhdar Brahimi, the special envoy of the United Nations and the Arab Countries, the Russian Foreign Minister Sergey Lavrov said that “the West has achieved success in making decisions at the UN Security Council for further aggravation of the situation in Syria and the creation of conditions for the exchange of power.”¹⁶⁸ Afterwards Lavrov, during the meeting with the Egyptian Foreign Minister Mohamed Kamel Amr also announced at the press conference, that about Syria, “Russia doesn’t focus on specific person, only cares about the people in Syria”.¹⁶⁹ Lavrov also said that Russia would continue cooperation in military and technical field with Damascus but they are not in an effort to support any power in Syria.¹⁷⁰ During this period, upon the issue of arms sales between Russia and Syria on the agenda again, Lavrov announced that “we provide weapons to Syria does not mean that we support President Bashar Al-Assad, but for our commitments in Soviet period”.¹⁷¹ However, Russia organized meeting with Syrian opposition leaders as well as supplying military aids to President Bashar Al-Assad. Then Russian Deputy Foreign Minister Mikhail Bogdanov met in Turkey with representatives of Syria Opponents Outside Syria to discuss ways to the resolution of the situation in Syria.¹⁷²

December 2012: On 3 December 2012, after President Putin's visit to Turkey, in the national press and the Western news sources have taken place some news that Turkey and Russia agreed to Assad’s leaving from Syria.¹⁷³ However, the news, based on a report released in the New York Times suggested that Turkey and Russia have agreed to Assad’s going, are starting to take place quickly.¹⁷⁴ Following this news, Russian press did not receive a confirmation of the reports and did not come an official statement from the Kremlin. In the meant time, Russian Pravda published an article of Lyuba Lulko of “Has Putin yielded Assad to the West of Turkey?” Lulko stated in the article that Russian interests, which Turkey is threatening to destroy are arms agreements, military base and the Russian nationals, who are located in Syria. Moreover Lulko emphasized that instead of establishing a patriot defense system against Syria, Turkey exceedingly needs to establish this system against Kurdish guerillas.¹⁷⁵ After Putin's visit it was also claimed in the western press that Russia will give asylum to Assad. Russian Foreign Minister Lavrov responded to these claims by stating that “such a right has not been granted to Assad” and added that he cannot say to Assad that Russia has been withdrawn, it’s not because of Assad is indispensable, it’s because Syria is as long as a democratic and free country, it is not very important, who manage it.¹⁷⁶

January 2013: Russia sent three warships led by Admiral Kuznetsov to the Mediterranean Sea in order to send the message that the Russian Navy after twenty-year break, was back into international waters.¹⁷⁷ In order to explain the arrival of Russian warships Damascus made a statement

¹⁶⁸ Rusya'nın Sesi, “Lavrov Batıyı Suriye Hükümetini Devirmeye Çalışmakla Suçladı”, 5 November 2012, http://turkish.ruvr.ru/2012_11_05/Lavrov-batiyi-Suriye-hukümetini-devirmeye-chalishmakla-suchladi/

¹⁶⁹ CNNTURK, “Rusya: "Suriye'de Bir İsme Odaklanmıyoruz", 5 November 2012, <http://www.cnntrk.com/2012/dunya/11/05/rusya.suriyede.bir.isme.odaklanmıyoruz/683320.0>,

¹⁷⁰ Star Gazetesi, “Rusya: Suriye’de Silahlı Çatışmanın Tarafı Olmayız, 28 November 2012, <http://haber.stargazete.com/dunya/rusya-suriyede-silahlı-catismanın-tarafı-olmayız/haber-707584>

¹⁷¹ RIA NOVOSTI, “Russian Weapons Supply To Syria Fulfills Old Contract – Lavrov”, 5 November 2012, http://en.rian.ru/mlitary_news/20121105/177201574.html

¹⁷² Rusya'nın Sesi, “Rusya Dışişleri Bakan Yardımcısı İstanbul’da Suriyeli Muhaliflerle Biraraya Geldi, 20 November 2012, http://turkish.ruvr.ru/2012_11_20/Rusya-Dishishleri-Bakan-Yardimcisi-istanbulda-Suriyeli-muhaliflerle-biraraya-geldi

¹⁷³ T24, “Putin'den Erdoğan'a: Esad Kalmakta Kararlı, Gitmeye Kim İkna Edecek?, 4 December 2012, <http://t24.com.tr/haber/putinden-erdogana-esad-kalmakta-kararlı-gitmeye-kim-ikna-edecek/218867>

¹⁷⁴ Türkrus, “NYT'nin İddiası: "Türkiye ve Rusya Anlaştı, Moskova Esad'ı İkna Etmeye Çalışacak", 6 December 2012, <http://www.turkrus.com/haber-hatti/58745/nytnin-iddiasi->, HaberTürk, “Putin Esad'a 'Git' Diyecek”, 5 December 2012, <http://www.haberturk.com/dunya/haber/800721-putin-esada-git-diyecek>, Dünya Bülteni,

“Putin'nin Ziyaretiyle İlgili Yapılan Yorumlar, 4 December 2012, <http://www.dunyabulteni.net/?aType=haber&ArticleID=237446,4.12.2012>, Forbes, “Is Russia About To Ditch Syria? The Truth Is That It May Not Matter”, 4 December 2012, <http://www.forbes.com/sites/markadomanis/2012/12/04/is-russia-about-to-ditch-syria-the-truth-is-that-it-may-not-matter/>

¹⁷⁵ Lulko, Lyuba “Has Putin Yielded Assad to the West in Turkey?”, Pravda, 4 December 2012, http://english.pravda.ru/russia/politics/04-12-2012/123023-putin_turkey-0/, Любовь Люлько, Путин в Турции: Запад и Катар не у дел, <http://www.pravda.ru/world/asia/middleeast/04-12-2012/1137074-visit-0/>

¹⁷⁶ RT, “Russia Will Not Grant Asylum to Syrian President – Lavrov”, 27 September 2012, <http://rt.com/politics/russia-syria-lavrov-rose-assad-115/>

¹⁷⁷ Trenin, Dmitri, “The Mythical Alliance: Russia’s Syria Policy”, The Carnegie Papers, February 2013, p.12.

that “the Russian navy will patrol to protect the waters of Syria.”¹⁷⁸ On the other hand, Moscow announced that they are ready to help starting a dialogue between the management of Syria and the opposition. Russian Foreign Ministry spokesman Alexander Lukashevich highlighted that Russia's position has not changed, to put an end to conflicts in Syria speeches about the importance of the Declaration of Geneva should be converted into practical measures as soon as possible.¹⁷⁹ One of the most important developments in the month of January is the news that Russia evacuated its citizens, located in Syria. Russian Foreign Minister Lavrov announced about the issue that Moscow does not think to reduce the number of personnel at the Russian Embassy in Damascus and did not evacuate its citizens in Syria.¹⁸⁰ Lavrov, on the other hand, drew attention to that the opponents of Syria to topple Assad follows the wrong way and to continue in this manner in the event of incidents more and more people will die.¹⁸¹ Finally in January 2013, Russia has performed the largest exercise in the last twenty years in the Mediterranean and the Black Sea¹⁸² in order to give a message that the Russians are in the Mediterranean again.

It is known that, from time to time Russia comes together with the opponents not only in Moscow but also in Syria and the aim is not to foment Assad regime but to prepare for the future. Not to mention that Russia benefited from the student exchange agreements between the two countries since 1960. Within the scope of the exchange programs, Russia welcomes many Syrian students in Moscow. Among these students there are also young people from Committee of National Cooperation. These young people were interviewed with Lavrov on November 29 in 2012 and during the meeting they stated that Russia should not be next to the regime.¹⁸³ Indeed, the committee, with the aim of achieving reconciliation with Assad in Russia, is working to obtain a place in Moscow in the post-Assad term. This initiative made by Moscow in the field of education in the post-Assad term will be useful in terms of location in the region of Moscow.

Moscow-Washington Tension: A New Cold War or a Partnership in Syria?

There has been a tension between Moscow and Washington that has been on the ascent since 2012. Upon the increased tension after the issuance of the Magnitsky Decision by the US Senate in December 2012, the Russian authorities announced that they will respond to the USA in all their announcements and recognized Magnitsky Act as exigent issue. Russian President Putin has pointed that the US does not have the right to make ethical decisions that would affect the legal system of Russia since the US also has human rights violations problems such as Guantanamo and Abu Ghaib.¹⁸⁴

Russia responded to the “Magnitsky Act” as a reprisal by accepting the “Dmitriy Yakovlev Act” which banned the US citizens to adopt orphaned children in Russia in 21st of December 2012. While Dmitriy Yakovlev Act does not only predict the banning of adopting orphaned children in Russia by the US citizens but also the citizens of countries that violate the rights of Russians and prohibits the activities of the NGOs that are financed by the USA and constitute a threat to the Russian interests within the country. Within this framework, this act envisions the prohibition of the entry of those in Russia who violated the rights of Russians or got involved in crimes against the Russian

¹⁷⁸ TRT, “3 Rus Savaş Gemisi Akdeniz’de”, 23 November 2011, <http://www.trthaber.com/haber/gundem/3-rus-savas-gemisi-akdenizde-17330.html>

¹⁷⁹ Rusya’nın Sesi, “Rusya, Suriye Diyaloguna Yardım Etmeye Hazır”, http://turkish.ruvr.ru/2013_01_10/Rusya-Suriye-diyaloguna-yardim/

¹⁸⁰ Rusya’nın Sesi, “Lavrov: Suriye’deki Vatandaşlarımızın Tahliyesine Henüz Başlamadık”, 23 January 2013, http://turkish.ruvr.ru/2013_01_23/Lavrov-Suriyedeki-vatandaslarimiz-in-tahliyesi/

¹⁸¹ Rusya’nın Sesi, “Lavrov Suriye Muhaliflerinin Esad’ı Devirmek İçin Yanlış Bir Yol Katettiklerini Düşünüyor”, 23 January 2013, http://turkish.ruvr.ru/2013_01_23/Lavrov-Suriye-muhaliflerinin-esadi-devirmek-yanlis-yol/, Karpukhin, Sergei, “Russia Denies Plans For Mass Evacuation From Syria, Defends U.S. Adoptions Ban”, 23 January 2012, http://www.washingtonpost.com/world/russia-defends-adoption-ban-denies-plans-for-mass-evacuation-from-syria/2013/01/23/6d2436e0-6559-11e2-85f5-a8a9228e55e7_story.html

¹⁸² RIA NOVOSTI, “Russia ‘Flexes Muscles’ in Mediterranean Amid Syrian Crisis”, 20 January 2013, http://en.rian.ru/military_news/20130120/178894932/Russia-Flexes-Muscles-in-Mediterranean-Amid-Syrian-Crisis-----html

¹⁸³ World Time, “Russia and Its Syrian Debacle: When the Enemy of My Friend Becomes My Friend”, 14 December 2012, <http://world.time.com/2012/12/14/russia-and-its-syrian-debacle-when-the-enemy-of-my-friend-becomes-my-friend/>

¹⁸⁴ Telegraph, “Vladimir Putin Backs Plan to Make US Adoptions From Russia Illegal”, 20 December 2012, <http://www.telegraph.co.uk/news/worldnews/vladimir-putin/9758327/Vladimir-Putin-backs-plan-to-make-US-adoptions-from-Russia-illegal.html>

citizens and closing down their companies in Russia.¹⁸⁵ After the act Russia classified the NGOs that receive foreign aid as “foreign agents”¹⁸⁶ asked USAID which had been operating in Russia for 20 years and which accused of intervening in the politics and trying to affect the election results to stop its activities in Russia in September 2012 as of 1st of October 2012.¹⁸⁷ Therefore Russia liaised USAID activities with US intelligence services. On the other hand there are other events that raised the tensions between Russia and the US in January 2013:

1. The Jewish Chabad-Lubavitch Hassidic movement whose center is in the US has sued the Russian government for the relocation of the “Schneerson Library” which was moved to Russia during the World War I and kept in the Lenin Library since 1918, and the Federal court that oversaw the issue in the USA decided that the Russian Government should pay 50 thousand dollars for each day that it does not relocate the library and Moscow announced that its response will be very harsh.¹⁸⁸
2. Russian Premier Dimitriy Medvedev signed the decree that ends the Security and Drug Traffic Control treaty signed between the US and Russia in 25th of September 2002.¹⁸⁹
3. Russia’s UN Permanent Representative Vitaly Churkin announced that Russia demands the explanation of the information concerning the supply of 20 tons of weapons to Libya from Qatar with the aid of the US during the peak of the Libyan crisis from Washington.¹⁹⁰
4. Russia announced that it will stop the import of meat from the US as of 11th of February 2013 and this sanction will be for the long term.¹⁹¹

As a matter of fact, there are also developments that constitute a contradiction with these tensions in the bilateral relations between the US and Russia. On November 2012, before the US elections, the name of John Kerry passed as a preferred candidate in the Kommersant Newspaper for the Minister of foreign affairs and there were expressions by an anonymous ministry staff concerning Hillary Clinton as “over-ambitious and aggressive”.¹⁹² In consequence, Moscow announced that Russia hope to enter more friendly relations with the US and to improve the relations that had been going sour in the recent years after the appointment of John Kerry as the minister of foreign affairs. The fact that a candidate supported by Russia despite the tension might be regarded as an important development for Syria, Iran, and even the Asia Pacific region.

Conclusion

In conclusion, it is obvious that Russia considers the post-Assad period in order not to be excluded in the process as in the case of Libya. Although it seems as if Moscow did not change its stance concerning Syria, Russia also continues talks with the key actors for the post-Essad period. In this respect, it can be assumed that the tension between Moscow and Washington is a distraction policy for the agreement of two countries on Syrian crisis. Trenin rightly underlines the fact the main disagreement between Russia and the rest, including United States, Turkey and Arab countries was that Russia insists that Syria is up to the Syrians themselves and outsiders should abstain from interfering or from sanctioning Damascus.¹⁹³ Still, Russia has a range of interests in Syria itself: a

¹⁸⁵ Rusya'nın Sesi, “Rusya’yı Korkutmayın, Rusya Hiçbir Şeyden Korkmaz”, 23 December 2012, http://turkish.ruvr.ru/2012_12_23/Rusyayi-korkutmayin-Rusya-hicbir-sheyden-korkmaz/

¹⁸⁶ RIA NOVOSTI, “NGO Law Comes into Force in Russia”, 20 November 2012, <http://en.rian.ru/russia/20121120/177597400.html>

¹⁸⁷ HaberTürk, “Rusya USAID’e Kapıyı Gösterdi”, 20 September 2012, <http://www.haberturk.com/dunya/haber/777950-rusya-usaida-kapiyi-gosterdi,20.09.2012>

¹⁸⁸ INTERFAX, “Schneerson Collection Cannot be Handed Over to Private Hands, Outside Russia - Culture Ministry”, 17 January 2013, <http://www.interfax-religion.com/?act=news&div=10207>, Türkrus, “Yahudiler ABD’de Dava kazandı, Rusya’ya Her Gün 50 Bin Dolar Kutsal Kitap Cezası”, 18 January 2013, <http://www.turkrus.com/haber-hatti/59309/yahudiler-abdde-dava-kazandirusyaya-her-gun-50-bin-dolar->

¹⁸⁹ RIA NOVOSTI, “Russia Scraps Deal on US Crime-Fighting Aid”, 30 January 2013, <http://en.rian.ru/politics/20130130/179117712/Russia-Terminates-Anti-Crime-Cooperation-Deal-With-US-----.html>

¹⁹⁰ Türkrus, “Rusya, ABD’den Libya’ya Silah Satışı Konusunda Açıklama Bekliyor”, 30 January 2013, http://turkish.ruvr.ru/2013_01_30/Rusya-ABDden-Libyaya-silah-satisi-aciklama/

¹⁹¹ Food Safety News, “Russia to Ban U.S. Meat Over Ractopamine Residues This Month”, 1 February 2013, <http://www.foodsafetynews.com/2013/02/russia-to-ban-u-s-meat-over-ractopamine-residues-this-month/#.UQ6-sx02nkZ>

¹⁹² Telegraph, “Russia Wants John Kerry, Not Susan Rice as US Secretary of State”, 8 November 2012, <http://www.telegraph.co.uk/news/worldnews/us-election/9663613/Russia-wants-John-Kerry-not-Susan-Rice-as-US-Secretary-of-State.html>

¹⁹³ Trenin, Dmitri, *ibid*, February 2013, p.19.

naval base located in Tartous, large arms market; commercial activities such energy contracts; an ally government; and a large number of Russian nationals.¹⁹⁴ Russian unobstructed foreign policy approach commenced in June 2011 with the statement of Russian Deputy Ambassador to the UN, Alexander Pankin as; “the current situation in Syria, despite an increase in tension and confrontation, does not present a threat to international peace and security...A real threat to regional security, in our view, could arise from outside interference in Syria’s domestic situation”¹⁹⁵ and did not alter until today.

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¹⁹⁴ IISS Strategic Comments, “Russia’s Syrian Stance: Principles Self-Interest”, Vol.18, Comment 31, September 2012, p.3.

¹⁹⁵ Khlebnikov, Alexander, “Why is Russia Standing by Syria?”, Telaviv Notes, Vol.5, No.18, 26 September 2011, p. 4.

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AGRICULTURAL RELATIONS BETWEEN MOROCCO AND THE EUROPEAN UNION

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Abstract:

The relations between Morocco and the European Union rotate, especially from the Moroccan side, around one single desire: The creation of a Free Trade Zone (FTZ). From the first EU-Morocco Euro-Mediterranean Association Agreement (1996) until the new Agreement on Agriculture (2010), through the granting of Advanced Status to Morocco (2008), most agricultural and industrial products enjoyed certain privileges, financial advantages and finally their practical liberalisation on the EU market.

This research will focus on the analytical study of the Institutional Framework to develop relations between the EU and Morocco on agriculture. In this sense, we will analyze: Firstly, the legal framework that legally and politically regulates these relations, i.e. the Treaty on European Union (1992) and the European Neighbourhood Policy (2004); secondly, the agreements that have had the greatest impact on agricultural development in Morocco.

Key Words: Moroccan Agriculture, Treaty on European Union, European Neighbourhood Policy, Euro-Mediterranean Association Agreement, Agreement on Agriculture.

Introduction

The agricultural activity of any region, though rooted in the customs and most genuine knowledge of their culture, depends on more global behaviours, both regarding its technological, political and economic management. Morocco, like any other country that seeks to evolve agronomically, is not an exception. In fact, mainly due to its strategic geographic location and the nature of its socioeconomic structure, its agricultural activity develops in a complex network of political, diplomatic and economic relations. Europe constitutes a main, crucial relation with Morocco, without which the Moroccan production would be practically marginal.

In the present paper we intend to provide a synoptic vision of all the relations the Alaouite kingdom has established with Europe on agricultural development, since its political independence from the Spanish-French Protectorate (1956) until the present. We will try, as well, to contextualise them in the geographic and economic peculiarities of the Moroccan agricultural sector.

Morocco is a preferred partner of the EU. This recognition was granted by the EU Council in a document known as Advanced Status (2008), which was signed by both parties after a long and intense political and diplomatic effort that was made prior to the Euro-Mediterranean Agreement between the EU and Morocco of 1996. The idea that has been pursued since then is to create a Free Trade Area between the EU and Morocco for agricultural and industrial products, as well as to test aspects of European International Policy. These and other concerns would result in the European Neighbourhood Policy (2004): New policy framework and, at the same time, the establishment of all the relationships between the EU and Mediterranean partner countries.

Precisely within this new political and diplomatic framework, with its legal basis in *The Treaty of European Union*¹⁹⁶ (Maastricht, 1992), all action plans that would affect the subsequent boost for the Moroccan agriculture would be designed and approved. The idea and the desire of the Moroccan government were to project total liberalization of agricultural products. This intention, although widely criticized by many of the producers of southern Communities, is gradually being

¹⁹⁶In this research, the consolidated version of the EU Treaty (Maastricht, 1992) is taken as reference, published in the *Official Journal of the European Union* on December 29, 2006, which introduces amendments to the Treaty of Athens, signed on April 16, 2003.

materialized, agreement after agreement. Actually, the new Morocco-EU Agricultural Agreement (2010), which came into force on the 1st of October, 2012, involves practical liberalization of fruit and vegetable exports from Morocco to EU markets. This is one clear example of the achievements in foreign policy obtained by the Kingdom of Morocco, which will be explained in more detail later on in this paper.

General Framework Of The Relations Between The Eu And Morocco-Eu **The Legal Foundation of relations between the EU and Morocco: The EU Treaty**

Relations between Morocco and the European Union were intensified since the beginning of Mohammed the Fifth's reign (1999); marked mainly due to the collaboration and cooperation. Morocco has therefore managed to be at the top of the list of members who benefit from the financial support of the European Union. It is a pioneer in the European Neighbourhood Policy (later to be explained) and also participates in the integration of the single market on the basis of the gradual adoption of the acquit and the Community border cooperation. Morocco, in short, was defined by the European Union as a "privileged partner" in the Advanced Status granted in October 2008, which plans to expand the framework of bilateral, diplomatic and commercial relations between the two of them, as well as greater political dialogue, human and cultural exchanges, trade liberalization, a general approach for the Moroccan economy to get to the standards of the European internal market (Kausch, 2010: 2).

Although it is true that the relations between the Alaouite kingdom and the European Union began a few years after its political independence from the Spanish-French Protectorate (1956), thirteen years later the first partnership agreement between the two parties was signed, which was binding for a period of five years. It was replaced shortly afterwards by a global cooperation agreement signed on April 27, 1976, which proposed a not quite so reciprocal preferential basis: "Morocco practically did not give any concessions to the EU, while the community totally eliminated the rights and barriers to Moroccan industrial products at the time that major concessions on agricultural products were made"¹⁹⁷ (Moreno García, 2000: 9).

In any case, a new horizon for trade relations between Morocco and the EU would open with the signing of the Euro-Mediterranean Association Agreement in 1996 between the European Union and Morocco, which was legally binded on the 1st of March, 2000. This will need to be explained in further detail throughout the paper.

So far it is necessary, despite the anachronism, to approach the European Neighbourhood Policy (ENP) of 2004 in a synoptic way, which contains the fundamental political principles that regulate such relations and consequently go back to the EU Treaty, in its consolidated version of 2006, the legal basis of the previous one.

The Fifth Chapter of The European Union Treaty articulates and regulates the Common European Foreign and Security Policy (CFSP) between articles 11-28. The Union Council is the legislative body responsible for defining the principles and general guidelines for the CFSP, taking the necessary decisions thereon (article 13). However, the Union Presidency shall represent the EU's foreign and security policy, expressing the Union's position in international organizations and international conferences, with the assistance of the Council's General Secretary who will exercise the functions of High Representative of the Foreign and Security Policy (article 18). At the same time, the Presidency and the Commission shall consult the European Parliament concerning the main aspects and the basic options of the common, foreign and security policy, celebrating a debate on the progress made in CFSP every year (art. 21). Article 27 underlines the legal basis of its relations of cooperation, which in due respect has come forth with: a) The principles, objectives, general guidelines and consistency of the common foreign and security policy, and the decisions taken within the framework of this policy, b) The competences of the European Community and c) The consistency between all the Union's policies and its external activities.

It should be noted that the foreign trade and the international agreements are regulated in the Constitutive Treaty of the European Community (2006), especially in Articles 133 and 300. In the third paragraph of Article 133 it is stated that agreements would need to be negotiated with one or more States or international organizations: "The Commission shall make recommendations to the Council, which shall authorize it to open the necessary negotiations. Also, the Board and the

¹⁹⁷ The translation is mine.

Commission will be entitled to ensure that the negotiated agreements are compatible with internal policies and regulations of the Community. The Commission shall conduct these negotiations in consultation with a special committee appointed by the Council to assist in this task and within the framework of such directives as the Council may issue it; at last the Commission will report regularly to the special committee on the progress of the negotiations”. It shall apply to this article, finally, the relevant provisions of article 300 relating to agreements between the Community and one or more States or international organizations.

Political and instrumental framework of the relations between the EU-and Morocco: The European Neighbourhood Policy (2004)

Inspired and legally regulated by The Treaty of European Union (Maastricht, 1992), in the first decade of the new millennium started developing what we know today as the new European Neighbourhood Policy (ENP), ultimately communicated by the Commission in Brussels on 12th of May, 2004. However, already in the run up to the great expansion of 2005, which contributed to 10 new EU member states, was generally recognized that this extension would have significant implications for countries on the other side of the new borders of the European Union, mainly to the east. They argued that it should prevent or mitigate the negative effects and take advantage of the potential for developing mutually beneficial cooperation with the new neighbours. This is when the famous debate about the initiative of a “Wider Europe. A New Neighbourhood” starts.

The general character of the new policy was collected in a Communication Commission presented in March 2003. In the debate, the president of the Commission by that time, Romano Prodi, said that the new policy should aim to create a "circle of friends" where you could ultimately share “everything but institutions”. This suggestion was not accepted by the Council, but in the conclusions adopted in June 2003 the Council itself largely followed the proposals of the Commission. In late 2003, the ENP was born as we know it today, after the Rose Revolution in Georgia. A few months after this, the Council decided to include Georgia, Armenia and Azerbaijan in the new policy, thereafter called European Neighbourhood Policy. From this moment, the new policy would be extended to 6 Eastern countries (Ukraine, Moldova, Belarus, Georgia, Armenia and Azerbaijan) and 10 Southern countries (Morocco, Tunisia, Algeria, Libya, Egypt, Israel, Palestinian Territories, Jordan, Lebanon and Syria).

Overall, the ENP aims to strengthen the stability, security and prosperity of the EU and its eastern and southern neighbours, offering them an even closer relationship. At the same time, it seeks to prevent the emergence of new dividing lines between the enlarged EU and its neighbours. Although such closeness will depend at all times on the commitment of these countries and the EU on common values, especially on democracy, the State of law, good governance and respect for human rights and the principles of the economy of the market, free trade, sustainable development and poverty reduction.

The ENP finally takes shape in the form of both the Partnership and Cooperation Agreements and Euro-Mediterranean Association Agreements with neighbouring countries, whose principles are formulated and communicated in different Euro-Mediterranean Conferences (Table 1). The main instrument of this policy is embodied in specific action plans that, once agreed, explicit the entry into force of an association agreement or cooperation, also known as “Euromed”. In this regard, the Commission prepares a Plan of Action, then negotiates with the neighbouring country in question and must be approved by the whole governing body established under the respective “Euromed”.

Table 1. Euro-Mediterranean Conferences¹⁹⁸

Euro-Mediterranean Conference of Barcelona (1995)	The Barcelona Conference was the beginning of a new phase in relations between the countries of the Mediterranean basin. This was the holding of ministerial meetings to address the major political, economic and social points of the Mediterranean countries, and began on November 28, 1995 in Barcelona, at the request of the Spanish government. http://www.medlognews.com/archive/documents/dec_Barcelona_1995_es.pdf
Euro-Mediterranean Conference of Malta (1997)	It deepened and complemented <i>The Declaration of Principles and Objectives of Barcelona</i> . Considerable progress was made in the development of the Euro-

¹⁹⁸ The translation is mine.

Euro-Mediterranean Conference of Stuttgart (1999)	Mediterranean Association, despite the complex regional situation on security policy. http://www.medlognews.com/archive/documents/Conf_Malta_1997_en.pdf The Foreign Ministers meeting in Stuttgart discussed on the importance of providing stability to the Mediterranean area. The meeting discussed the development of the "Euro-Mediterranean Charter for Peace and Stability" and the progressive development of regional cooperation and preventive diplomacy. http://www.medlognews.com/archive/documents/Conf_Stuttgart_1999_en.pdf
Euro-Mediterranean Conference of Marseilles (2000)	In the French city of Marseille, The Ministers of Foreign Affairs discussed the situation in the Middle East and addressed the issue of cooperation on security policy. In regard to the economic and commercial, they reaffirmed the objective of creating a free trade area between The European Community and the Mediterranean partners. http://www.medlognews.com/archive/documents/conf_Marsella_2000_en.pdf
Euro-Mediterranean Confencia of Valencia (2002)	The Valencia meeting marked a turning point in the Euro-Mediterranean Conferences. The Ministers of Foreign Affairs established a Plan of Action to reinforce political dialogue and economic cooperation, trade and finance. http://www.medlognews.com/archive/documents/Conf_2002_Valencia_es.pdf
Euro-Mediterranean Conference of Naples (2003)	In the Italian city of Naples, the Ministers of Foreign Affairs approved the creation of the Euro-Mediterranean Parliamentary Assembly and the Anna Lindh Foundation for the Dialogue of Cultures, in order to promote knowledge of different cultures. It was also decided to create, with the support of the European Investment Bank (EIB), a mechanism of loan designed to encourage the development of the private sector in the Mediterranean countries. http://www.medlognews.com/archive/documents/Conf_2003_Naples_en.pdf
Euro-Mediterranean Conference of Luxembourg (2005)	The VII Conference allowed the representatives of governments debate on the major issues which affect the development of The Euromediterranean Partnership. Also here took place The Tenth Anniversary of the Barcelona Process. http://www.medlognews.com/archive/documents/Conf_2005_Luxemburgo_en.pdf
Euro-Mediterranean Conference of Barcelona (2005)	The Tenth Anniversary Cumbre of the Barcelona Process, known as "Barcelona +10", brought together the heads of State and Governments and the Ministers for Foreign Affairs European and Mediterranean to take an evaluation of the 10 years of the Barcelona Process and approve a work program to renovate their drive. http://www.medlognews.com/archive/documents/state_2005_Barcelona_en.pdf
Euro-Mediterranean Conference of Tampere (2006)	The conference in Tampere (Finland) insists on the security issues and the creation of free trade zone. http://www.medlognews.com/archive/documents/Conclusiones%20Tampere%202006_eng.pdf
Euro-Mediterranean Conference of Lisbon (2007)	This conference recognized the important role of the social economy in the economic and social development of the Mediterranean, through the participatory management of its members and beneficiaries in productivity, competitiveness, solidarity and social responsibility. http://www.medlognews.com/archive/documents/Conf_Lisboa2007.pdf
Euro-Mediterranean Conference of Paris (2008)	More than forty heads of State and Governments of the EU and Mediterranean countries participated in the summit of July 13, 2008 in Paris to launch the "Barcelona Process: Union for the Mediterranean". http://www.medlognews.com/archive/documents/ConfParis08.pdf
Statutes of the European Union for the Mediterranean (2010)	The Statute of the European Union for the Mediterranean was approved on March 3, 2010 in the city of Barcelona. http://www.medlognews.com/archive/documents/ESTATUTOS_UPM_EN.pdf

Sources: collection and documentation available on: www.medlognews.com; <http://www.europarl.europa.eu/>; <http://ec.europa.eu>.

In general, each Action Plan contains a number of objectives and measures that are formulated within a framework of political and economic reforms. They keep enough similarity to processes whose objective is the accession to the EU and the support to the candidate countries' reforms, setting a specific action project (Galduf Jordan, 2004).

Finally, they are also used under the ENP instruments as the European Instrument for Democracy and Human Rights, the Development Cooperation Instrument on migration or the Humanitarian Aid Instrument and the Macrofinancial Assistance.

The Agricultural Relations Between The Eu And Morocco The Euro-Mediterranean Association Agreement EU-Morocco (1996) and its impact on agriculture.

On the 27th and 28th of November 1995 the representatives of the Council and the Commission of the European Union as well as 12 representatives of the Mediterranean countries (Algeria, Cyprus, Egypt, Israel, Jordan, Lebanon, Malta, Morocco, Syria, Tunisia, Turkey and the Palestinian Authority) met in the Euro-Mediterranean Conference of Barcelona, in order to communicate a new framework for multilateral cooperation between them. This is an unparalleled historical event and marks a new phase in the foreign policy of the EU because, for the first time social, economic, human, cultural and security policy would be discussed. This spirit is created as the new partnership is set, mainly showing solidarity and respect for the specificities of each country and completing the former activities and initiatives undertaken in favour of peace, stability and regional development (De Arce Borde y Escribano Francés, 2001).

Between then and 2005, the EU held seven Euro-Mediterranean agreements with different Mediterranean countries. One of these would be the new Euro-Mediterranean Agreement with Morocco, signed on February 26, 1996, but would take effect on March 1, 2000, after a long process of ratification in the European Parliament. Its purpose is already expressed in art. 1 of the Decision of the Council and the Commission of 24 January 2000:

- Provide an appropriate framework for the political dialogue between the Parties allowing the development of their relations.
- Establish the conditions of progressive liberalization of trade in goods, services and capital.
- Develop trade and the development of social and economic relations between the Parties.
- Encourage the Maghreb integration by promoting trade and cooperation between Morocco and the countries of the region.
- Increase cooperation in the economic, social, cultural and financial scope.

Trade liberalization represented the core of most attention in this Agreement. The gradual introduction, in 12 years, of a Free Trade Area (FTA) was proposed and, consequently, the Moroccan market opened to the EU. This aspect was not covered in previous bilateral agreements¹⁹⁹. Chapters II 'Free movement of goods' and III 'Common Provisions' regulate in their articles this FTA and their annexes and protocols, which reflect the specific issues concerning agricultural and fishery trade, rules of origin and customs treatment.

In general, Moroccan agricultural and fishery products, although winning concessions when compared to previous stages, benefit in this Agreement from less advantages than the industrial products, which are allowed to be imported from the European Community free of customs duties and charges of an equivalent effect (Article 9). However, in Protocols 1, 2 and 3 a series of reciprocal concessions reviewable in agriculture and fisheries are established; revisions that, according to Article 18, must be made along the same year in favour of further liberalization of these products. The binding was, in short, the total or partial reduction of *ad valorem* tariffs²⁰⁰ on imports into the EU of products originating in Morocco. Such tariff reduction was subject, in most cases, at three types of constraints²⁰¹ (Moreno Garcia, 2000:13):

1. Products for which a tariff quota is established within which the tariff concession is applied.
2. Products for which reference quantities are defined.
3. Products for which the Community reserves the right to establish a reference quantity and possibly a subsequent quota for a volume equivalent to it.

This Agreement also incorporated specific treatment for sensitive agricultural products to the Community (Table 2). In this case, the concessions were subject to input prices gradually declined at the same rate and terms of input prices consolidated before the World Trade Organization (WTO). Morocco promised not to exceed the established quotas (matter that did not happen with the tomato, for example). As for the entry of agricultural products originating from the EU in Morocco, it only

¹⁹⁹ We refer to the Association Agreement of 1969, replaced by the Global Cooperation Agreement signed on 27 April 1976 and which entered into force on 1 November 1979.

²⁰⁰ Ad valorem tariff is a tariff that is imposed as a percentage of the value of the merchandise. For example, 5% tariff means that the import tariff is 5% of the value of the merchandise in question.

²⁰¹ The translation is mine.

guaranteed maximum customs duties within tariff quotas for a total of 46 line items, as set out in Protocol 3 of the Agreement.

Table 2. Moroccan sensitive agricultural products in the EU market

Specific treatment for certain products Moroccan by EU			
Product	Period	Quota in 1997	Input price (euro/ton)
Fresh tomato..... (0702.00)	October	500	500
	November	18.601	500
	December	36.170	500
	January	30.749	500
	February	33.091	500
	March	27.065	500
	October to March	150.676	500
Fresh Courgette (0709.00)	1 st October to 20 th April	5.000	451
Artichoke..... (0709-10)	1 st November to 31 th December	500	600
	Cucumbers..... (0707)	1 st November to 31 th May	5.000
Clementines..... (0805.20)			110.000
Fresh oranges..... (0805.10)	1 st November-At the end of February	300.000	275
	1 st . December to 30 th May		

Source²⁰²: Moreno García, 2000.

To sum up, the EU- Mediterranean Agreement between the EU and Morocco (1996-2000) advanced in a theoretical project of free trade area of industrial, agricultural and fishery goods. In this sense, a large volume of industrial products from Morocco won the total tariff exemption from the same date, and many others would be obtained in March 2003 (Moreno García, 2000). For the other half of the industrial goods, tariff dismantling would begin in March 2003. In the agricultural sector, on the other hand, a partial liberalization was carried out, with a series of specific treatments for certain sensitive products in the productive sector of the Community.

The renewal of the Agreement in 2003 and the European Neighbourhood Policy (2004).

Among articles 16 and 18 of the Agreement of 1996 it was specified that, overall, the agreement involved a package of measures that should be extended every five years, up to the full opening of their markets and the effective creation of a free trade area in the industrial and agricultural sector. For this reason, in the Roadmap Action Plans it was foreshadowed that, in 2000, the renewal and expansion of trade-offs for these productive sectors would be negotiated.

Moreover, the European Commission prepared a mandate for the negotiation already in the spring of 2000, in order to apply the new terms in January 2001. Morocco, however, refused to negotiate until late 2002 and, when it did, it made proposals with an impossible acceptance. Finally, when it agreed to a negotiation in realistic terms, it was patiently lengthened so much that its conclusion was possible only in December 2003 (Jaso Cortés, 2004: 28). Thus, the entry into force of the new liberalization package came three years late, in early 2004.

²⁰² The translation is mine.

The content of the new agreement resulted in a new version of Protocol 3 of the previous Agreement of 1996, materializing in tariff quotas, whose total number has doubled from 45 to a total of 100 (Jordan Galduf, Garcia Alvarez-Coque and Gómez Martínez, 2011). On the other hand, preferential rights were considerably improved, whose first result was the complete disappearance of tariff quotas on a large group of products and increased volume. However, with the entry into force of the new Agreement in December 2003, Morocco was only granted a total of 156 preferences to their products, compared to 152 in 1996. And, although full liberalization remains the main instrument of the new agreement, the number of agricultural products for which was granted this power fell from 83 to 79. This change is mainly due to the non-use of the mechanism of 'Quantities of preference', which was present in 1996 (Jaso Cortés, 2004). Finally, emphasize that the fresh tomato was, again, the product that raised concerns in this Agreement for the EU farmers, because Morocco was granted a significant increase in the quota.

Spain with Morocco, for example, competes, cooperates and has a dependency on its workforce. In the case of Andalusia, and specifically the Huelva coast, recent harvests of strawberries were practically taken forward with manpower from Morocco. But once in circulation in the Community market, Huelva strawberries compete directly with the strawberries produced in Morocco. The same competition occurs with many other crops of the Andalusian coast and northern Morocco (Table 3), which has been shaping ostensible differences between "bound landscapes" and "ephemeral landscapes" (Márquez Domínguez., 2008).

Table 3. Harvested area in thousands of hectares

Consolidated landscapes,2005	Spain	Morocco	Andalusia
Harvested area (1000 ha.)	(1)	(1)	(2)
Avocados	8.80	1.61	8.53
Apricots	19.86	12.00	0,24
Cherries	25.86	1.30	3,01
Plums and sloes	19.57	7.90	2,65
Lemons and limes	47.31	1.00	8,16
Peaches and nectarines	78.45	4.50	11,35
Oranges	135.67	48.85	44,58
Pears and quinces	37.47	7.20	1,16
Tangerines, mandarins and clementines	118.36	24.00	11,60
Ephemeral Landscapes, 2005	Spain	Morocco	Andalusia
Strawberries	7.60	3.14	7,31
Garlic	18.00	4.10	6,30
Artichokes	18.60	3.65	2,95
Aubergines	3.00	2.55	2,44
Pumpkins	7.00	6.78	4,74
Onions (incl. shallots)	24.60	29.60	3,85
Chillies and green peppers,	23.50	6.54	16,64
Cabbages and other cruciferous	7.70	1.70	1,49
Cauliflower and brócoli	25.40	2.02	1,40
Asparagus	12.00	0.39	7,30
Green beans	17.50	17.63	9,16
Lettuce and chicory	36.20	0.21	11,73
Other melons (including cantaloupe)	38.50	27.34	9,49
Cucumbers and gherkins	7.20	1.10	6,11
Watermelons	15.80	12.96	8,22
Tomatoes	71.90	22.10	20,22
Carrots and turnips	5.00	16.21	4,13

Source²⁰³: Márquez Domínguez., 2008: 7.

Meanwhile, the launch in 2004 of the European Neighbourhood Policy (ENP) opened an unexplored horizon to create the promised FTA (FTA) between the EU and neighbouring countries of the Mediterranean, as this FTA was enshrined as the main objective of this new policy. Regarding Morocco, it represents its main political and economic support, whose endowment reached the figure

²⁰³ The translation is mine.

of 11.9 billion euros for the period 2007-2013 under the European Neighbourhood Policy Instrument (ENPI) (Canary Islands Government, 2011). Within this new framework, and after the "Report Country-Morocco" that the European Commission presented in May 2004, the Action Plan EU-Morocco was approved in 2005, for a period of five years, Morocco became one of the first countries to sign a Neighbourhood Action Plan with the EU. In the Strategic Report for 2007-2013, including in the ENPI, the five priority areas for financial cooperation and financial share of each item are established (Table 4):

Table 4. Strategic priorities for financial cooperation EU-Morocco (2007-2010)

Prioridad Estratégica	% Millones de euros	Measures
Social area	45,09%	1.INDH 2.Literacy teaching 3.Education 4. Support for basic health coverage 5. Health Service
Governance Human rights	4,29%	1. Support to the Ministry of Justice 2. Human Rights
Institutional Support	6,13%	1. Public Administration Reform 2.PAPA
Economic Area	36,89%	1.Private Sector 2.Professional Education 3.Agrarian Sector 4.Rocade proyect 5.Connecting remote areas 6.Energy Sector
Environment	7,66%	1.FODEP 2. Hydric sanitation

Source²⁰⁴: European Neighbourhood Instrument and Partnership. Morocco Strategy Paper 2007-2013. National Indicative Programme 2007-2010.

The ENPI assumed, in addition, all territorial programs financed by the EU in the countries benefiting from the ENP, as the *Technical Assistance to the Commonwealth of Independent States (TACIS)*, the Community Initiative concerning trans-European cooperation to encourage the harmonious and balanced development of the European territory (INTERREG) or the Poland and Hungary program: Assistance for Restructuring their Economies (PHARE), among others. The aim is to simplify the political and administrative structures, based on principles of multi-annual programming, partnership and co-financing and aims to promote cross-border and interregional cooperation.

From the granting of the Advanced Status (2008) to Morocco to the New Agricultural Agreement of 2010

After a new Council of the EU-Morocco Association held on October 13, 2008, a joint paper or 'roadmap' was published that filled old aspirations of the Alaouite kingdom: the so-called Advanced Status. It is a new adjustment of the ENP, which provides enhanced political dialogue and the gradual integration of Morocco into the internal market of the EU. Morocco consummated his stated intention, since the entry into force of the Association Agreement of 1996, to be distinguished from the other southern Mediterranean partner countries and bilateral and asymmetric approach of the ENP launched in Brussels in 2004 (Fernandez Molina., 2010).

At the start of the preliminary negotiations of the new Statute, between 2006 and 2007, the said Action Plan of the EU and Morocco, signed in 2005, was already fully operational under the guidance of the ENP, which may explain, in part, that his "Sheet Map" provides the implementation of "short-term measures," though without any precise deadlines. In general, the Moroccan desire got extended to the European Economic Area (EEA)-free movement of goods, services, capital and

²⁰⁴ The translation is mine.

people, and the preferential terms that were granted to the Eastern candidate countries during the pre-accession phase. Finally, this desire was only materialized in the following concrete measures agreed²⁰⁵ (Martin, 2008):

1. Intensification of the political dialogue.
2. Actions on safety (police, border control, combating terrorism, drug trafficking and crime in general) and on the judiciary, with a Moroccan institutional and legislative alignment to EU standards.
3. The medium-term creation of a common economic space inspired in the EEA rules, which would imply, in principle, an enhanced cooperation on regulatory convergence of Morocco with the EU. Also, a Deepened and Global Free Trade Agreement is negotiated that integrates in agriculture and services and not only in industrial products, as happened in the revised agreement in 2000.
4. It promotes economic dialogue between the two partners and, perhaps most innovative: a dialogue on employment, decent work and social affairs.
5. In the area of infrastructure a connection from Morocco to the major European networks of transport, communications and energy is expected.
6. Regarding agriculture, mining, environment and water, it promotes cooperation activities that complement the Moroccan regulatory convergence in each of these areas.
7. At the institutional level, it provides the participation of Morocco in a number of European agencies.
8. However, it is clearly established that the limits of the action of the EU, committed for such purposes, are already fixed in the Financial Perspectives of the Framework 2007-2013, establishing therefore the only short-term concession "optimization of new instruments and thematic programs".

Agriculture is very present in this Advanced Status, though not without some ambiguity. Considerations mostly revolve around Moroccan agricultural modernization, agreeing the following actions²⁰⁶ (EU Document conjoint sur le Maroc reinforcement des bilateral relations / Statut advance, 2008: 9-10):

1. Accelerate the implementation of actions to improve the Action Plan in the agricultural sector in order to achieve the creation of a transparent system with harmonized regulatory standards.
2. Support to the strategy for improving the Moroccan agriculture that was established in the "Green Morocco Plan" (2008), which aims to balance the agricultural activity in all economic activities of the country and support the entry of agricultural production in the world market and the markets of Morocco's main partners. This support may be provided through the organization of courses, capacity building, sanitary and phytosanitary standards, alignment with current regulations, sustainable resource management, etc., always under the existing cooperation mechanisms.
3. The collaboration between organizations of professional Moroccan producers and their European counterparts.
4. Establishing a system of recognition and articulation joint Moroccan and European geographical indications.

The ambiguity of this Advanced Status in agriculture is that²⁰⁷:

Not a single mention is done of the Common Agricultural Policy (CAP) or Morocco's participation in it, even in the long term, and, with respect to the opening of the European agricultural markets to Moroccan products, is left to the negotiations that were already in progress within the framework of the upcoming Partnership Agreement, without providing even a step further (Martin, 2008: 5).

Despite this apparent ambiguity, EU-Morocco relations on agriculture has intensified greatly after the granting of the Advanced Statute, especially regarding exports to the EU of certain Moroccan products. Recently, in 2009, they began to negotiate an Agreement in the form of an Exchange of Letters concerning reciprocal liberalization measures on agricultural products, processed agricultural products, fish and fishery products, which replaced Protocols 1, 2 and 3 of the Agricultural Agreement of 2003 and amended the Euro-Mediterranean Agreement of 1996 considerably.

²⁰⁵ The translation is mine.

²⁰⁶ The translation is mine.

²⁰⁷ Idem.

This new agreement would be signed on 13th of December, 2010 and finally ratified in February 2012 and entered into force the 1st of October. In general, it implies the practical liberalization of fruit and vegetable exports to the EU market from Morocco. Specifically, the Protocol abolishes the "*ad valorem* rights" for all fruits and vegetables, except tomatoes, garlicks, cucumbers, courgettes, tangerines and pears. For these products, tariff protection is also lower than the previous agreement. Similarly, the *ad valorem* rights are reduced by setting quotas with zero tariff and reductions above the quota, which are 60% for tomatoes and 80% for unlimited amounts of clementines. Finally, the great benefit for Morocco is related to the input prices, because the Agreement sets new concessions on products with reduced input prices and unlimited amounts, such as table grapes, apricots, peaches and nectarines.

Finally, it is important to emphasize that this new agreement has received strong opposition from the farming community, especially the Spanish one. The critics primarily focus on the weak phytosanitary requirements imposed to Moroccan products to come into the European markets, especially when we compare them with any community horticultural products. Consequently, most industrialized EU countries benefit the most from this agreement, because due to the liberalization of the agricultural trade with Morocco, they get to export their industrial products to Morocco at low tariffs.

Final conclusions

The institutional framework of the EU-Morocco cooperation on agriculture reveals, above all, the intense diplomatic, political and economic relations that both entities have been starring in decades.

The territorial, environmental and political contrasts in which Moroccan agricultural activities is being developed explain much of the internal weaknesses of this industry and, consequently, the need for foreign aid. The fact is that we are dealing with an economy in which the agricultural activity represents a significant 15% of the national GDP, to which must be added an uncompetitive industrial sector and a strong hidden economy. It is, in short, an unsteady subsistence economy, due to the fact that it is based essentially on agriculture, informal employment and the need of financial aid from abroad.

The EU is the main export destination for Moroccan fruit and vegetable products. For this reason the majority of signed agreements have essential impact on the agricultural Alaouite sector. From 1996 to the present, or, which is the same, from the first EU-Morocco Euro-Mediterranean Agreement to the new Agricultural Agreement ratified in February 2010, Moroccan agricultural products have been progressively liberalized until its practical immersion in a less theoretical European Free Trade Area. However, it is true that for certain sensitive products for the EU market (tomatoes, cucumbers, oranges, etc.) some protectionism is still practiced, in order to maintain the difficult balance between the producers of community countries and regions and the producers of neighbouring countries.

However, the most resistant political and legal limits for the Moroccan agriculture are carried out from the Common Agricultural Policy Agreements. None of it makes any reference to a hypothetical participation of Morocco in this policy. The reason seems obvious when one considers that Morocco is not an EU country. But this obvious fact conflicts with the intent of creating a Free Trade Area between the EU and Morocco, which partly explains the ambiguity that still permeates the agricultural agreements made.

Therefore, there is still no real Free Trade Agreement between the EU and Morocco. Although scholars have attributed the cause to the Moroccan sociopolitical structure, it may be due instead to the lack of interest of both authorities. However, this gap does not detract from diplomatic and political efforts subsumed and materialized in the shape of these agreements, with special incidence in agriculture, but it reminds us and suggests the long road that is still ahead for Morocco to internationalize their agricultural production and improve their performance and production structure.

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THE ROLE AND IMPORTANCE OF PUBLIC DIPLOMACY, ROMANIA CASE STUDY IN THE CONTEXT OF INTEGRATION INTO NATO

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Abstract:

The end of the Cold War and the predictable structure of international relations system, until then, on one hand, and changes caused by the disappearance of the two great powers, media diversification and appearance of the new non-state actors on the stage of international relations on the other hand, have led to new forms of diplomacy as an alternative to the traditional.

Contemporary international relations recorded, under the impact of globalization, a process of resizing, states and governments interact, as well as individuals and NGOs and as a result the state monopoly has been put aside. A wide range of non-state actors influence a country's image abroad and traditional diplomacy is going through changes, while the progress of information technology offers multiple communication mechanisms.

In the last part of this article I decided to analyze public diplomacy in the context of integration into NATO, primarily to highlight the importance of public diplomacy in the practical implementation of the theory and secondly because the post-revolutionary period, Romania posted two major successes: NATO and EU integration, both of which are results of the efforts made in public diplomacy.

Key Words: Public diplomacy, integration, accession, NATO, public opinion, foreign policy, international relations

*"Diplomacy is a deliberate juggling of words and gestures, for influential persons to ensure the success of interested diplomat"*²⁰⁸ Valeria Mahok

Diplomacy has its origins in the distant past, in the regional conventions and derives from the ancient Greek word "diplo" translated "double". This action meant drafting diplomas or official documents in 2 copies of which one was the mandate letter sent, and the other one was kept in the archives. The person who was in possession of such a doublet was called diplomat and the activity done by him was called diplomacy²⁰⁹. Diplomacy was the best way civilization could invent in order to ensure that international relations would not to be governed by force because war, as a means of resolving international, disputes is not practical nor harmless.

The concept of diplomacy is equivalent to dialogue. Diplomacy as a method is the opposite of war and of the policy of force in general. Flexibility is the essence of diplomacy, or seeking mutually acceptable solutions. From the scientific perspective, diplomacy has as its object studying political and legal relations of the various states, and the interests that generate them. As art, diplomacy, aims international business administration which involves the ability to order and manage political negotiations²¹⁰.

During long periods of history it has been observed that the diplomatical dominance of certain schools have influenced the diplomatical practice through their methods. First it should be mentioned the Greek and Roman diplomatic school. Therefore, the qualities that ambassadors should have considering that their only weapons are words and favorable moments, had been noticed. Greek diplomacy has formulated a set of principles which refer to key aspects of relations between states.

²⁰⁸ <http://autori.citatepedia.ro/de.php?p=44&a=Valeria+Mahok>

²⁰⁹ <http://facultate.regielive.ro/licente/drept/rolul-misiunilor-diplomatice-in-activitatea-diplomatica-internationala-295772.html>

²¹⁰ CHRISTOPHER ROSS, translated by Ana Golgi, For an assertive public diplomacy and promoting the image of a country Polirom Publishing House, Bucharest, 2008, p.60.

Although the Romans gave no proof of mobility and also ingenuity as good as the Greeks, being just disciplined city functionaries, they still have developed a rich diplomatic activity, especially in the eastern part of the empire. The Byzantine diplomatic school is known for their refined knowledge and practical skills, so pronounced that then diplomacy largely influenced medieval Venice, Italian States, Russia and Turkey. A part of the nations have taken many elements from the medieval Byzantine diplomacy, such as the system of gifts, the principle of the messenger's immunity, methods of handling or negotiation etc. The Venetian diplomatic school is very well known for the order that Venetians introduced in the state archives, carefully keeping letters and reports from their diplomatic agents. French diplomatic school becomes predominant in the early seventeenth century. French diplomatic practice progressed during the reign of Louis XVI. When he received a foreign ambassador, the Foreign Minister prepared a note in which was indicated not only what topics should be approached, but also what topics should be avoided. The Ottoman diplomacy has been characterized by harshness and arrogance, but when the Turks began their great retreat they paid more attention to talks and negotiations. Chinese diplomacy had developed an elaborate ceremony that created difficulties to foreign diplomats through formulas used at the court of the Emperor and the Japanese used the same method of passive resistance using a complicated ceremonial, Japanese messages always delay negotiations²¹¹.

From early times diplomacy was used to defuse tensions, conflictual moods, to normalize relations between states. According to Kissinger Henry²¹² who defines diplomacy as "*an adjustment of differences through negotiation*"²¹³ this process is possible only in the framework of the international system where legitimacy is prevailed.

When you cease the use of diplomatic means to resolve disputes, the exposure of force will not delay to appear, destroying the most valuable asset of any nation.

"*Peace is a vivid phenomenon of movement, achieved gradually, a purpose, a direction and no way to rest and complacency*"²¹⁴ defined Nicolae Titulescu²¹⁵ peace through the diplomatic channel.

Diplomacy is a constant negotiation with the receiving State with a diversified development. It does not take place only at the negotiating table. A diplomat must know how to negotiate strongly. He knows that if interests do not converge, any effort is in vain, because states do not have disinterested links, they have also government policy interests.

The diplomat's role is to make legitimate rights known and to establish a joint project to promote state interests that they represent. Any society, any social organism, in order to evolve, it must obey certain rules, even just from the desire to avoid clutter. A form of hierarchy exists, as we know, in any organized society. In an advanced society, the order becomes an unavoidable necessity and imperious because the infinite complexity of human relationships demand rules necessary to carry out peaceful life together.

In business, if you master the art of negotiation, you have an extra chance to win more and keep a good relationship with your partner. If you negotiate well, you can steer, influence and manipulate your partner to make him cooperate. Negotiation is a talent, a native gift but also a skill acquired through experience, training and learning. Nowadays diplomacy has an open character, the discussions are direct and economic diplomacy is on the first place. This is especially because of the import-export relations, trade, cooperation and economic confrontation²¹⁶.

With the creation of international institutions such as the League of Nations, there is a new diplomacy that is named international organization's diplomacy. Countries pay great attention to economic diplomacy, because today the battle is for economical power.²¹⁷

²¹¹ Melescanu Teodor Romanian diplomacy Renaissance 1994-1996, Dacia Publishing House, Cluj-Napoca, 2002, pp.23-31

²¹² Henry Alfred Kissinger (born on May 27, 1923) is a German-born American writer, political scientist, diplomat, and businessman. A recipient of the Nobel Peace Prize, he served as National Security Advisor and later concurrently as Secretary of State in the Administrations of Presidents Richard Nixon and Gerald Ford. After his term, his opinion was still sought by U.S. presidents and subsequent some other world leaders.

²¹³ Henry Kissinger, Does America Need a Foreign Policy? The XXI century diplomacy, Ed Incitatus, Bucharest, 2006, p.79.

²¹⁴ Walter M. Bacon, Titulescu and foreign policy of Romania, European Institute Publishing, 1999, Bucharest, p.246

²¹⁵ Titulescu (born March 4, 1882, Craiova - died March 17, 1941, Cannes) was a Romanian diplomat and politician, several times minister of foreign affairs, former president of the League of Nations. In the years 1928 - 1936, Titulescu was several times Minister for Foreign Affairs

²¹⁶ I Ghe BARBULESCU European Union: enlargement policy, Triton Publishing, Bucharest, 2006, p.162

²¹⁷ <http://en.wikipedia.org/wiki/Multilateralism>

Contemporary international relations recorded under the impact of globalization are passing through a process of resizing, which has the consequence of removing the state monopoly on foreign policy²¹⁸. A wide range of non-state actors influence a country's image abroad, and information technologies gives them multiple communication mechanisms. In this situation, diplomatic activities are accompanied by a process of communication, both internal and on external markets. More and more countries launch information campaigns designed to contribute to the foreign policy priorities, but also to obtain their support for these companies. In the context of participatory democracy, public adherence to government policy is indispensable for the survival of a government²¹⁹. External strategies are also part of these campaigns because they target the changes or strengthening of the international public perception towards a particular country.

"In international relations, the term" public diplomacy "has emerged to describe aspects of international relations that are manifested outside of interaction between state structures. The term "public diplomacy" was introduced into scientific circulation in 1965, when Edmund Gullion, a career diplomat and the dean of School of Law and Diplomacy, at Tufts University, created the Center for Public Diplomacy Edward R. Murrow. The center described this term as "*the influence of public attitude formation and execution of foreign policies*"²²⁰. This includes dimensions of international relations beyond traditional diplomacy, training by governments of public opinion in other countries; interaction between private interest groups in different countries public information on international affairs and their influence on domestic policy, communication between those whose function is communication, as diplomats and foreign journalists, the process of intercultural communication. Soon the term became useful for U.S. government offering necessary theoretical external business American Intelligence Agency (U.S. Information Agency)²²¹.

U.S. State Department defines public diplomacy as the U.S. government funded programs designed to inform or influence public opinion abroad²²², while Hans Tuch²²³ defines public diplomacy as a government communication process with the public foreign countries in an attempt to explain his ideas and ideals that nation, its institutions and its culture as well as national interests and policies²²⁴.

The former diplomat John Brown describes U.S. public diplomacy as a process which involves three roles: information dissemination, education and cultural exchanges²²⁵. Philip Taylor uses the term "management of perception" to describe the informational role of public diplomacy, drawing a distinction in this regard between public affairs, public interest, psychological operations, media management and public diplomacy. Researchers in the field of cultural diplomacy as Kevin Mulcahy and Harvie Feigenbaum emphasizes the difference between public and cultural diplomacy in that the first is oriented towards short-term information dissemination and promotion policies and the cultural to establish long-term relationships²²⁶. Public diplomacy as traditionally perceived, includes government support programs in the cultural field, educational, and informational exchanges of people, programs aimed at informing and influencing foreign audiences. Its mission is worldwide and essential in foreign policy being indispensable national interests, ideals and leadership in the world. U.S. Congressman Henry Hyde considers that "*the role established for our public diplomacy is to recruit people of the world in a common cause and to convince them that the objectives tend to*

²¹⁸ Erik Jones, Debating the translating relationship, Rhetoric and Reality, in *International Affairs*, 80, 2004, p 236

²¹⁹ <http://www.akademos.asm.md/files/Diplomatia%20publica%20componenta%20indispensabila%20a%20discursului%20extern%20in%20conditiile%20globalizarii.pdf>

²²⁰ Idem 14

²²¹ Idem 11

²²² Durkheim Emile, *Sociology. The rules of sociological method*, Ed Header, California, 2002, page 47

²²³ Hans N. Tuch, a retired Career Minister in the U.S. Foreign Service, served in public diplomacy positions in Germany, the Soviet Union, and Brazil. He was Deputy Chief of Mission and charge in Bulgaria and Brazil. In Washington, he served as Deputy and Area Director for the Soviet Union and Eastern Europe in USIA, and as Deputy and Acting Director of the Voice of America. After his retirement in 1985, he taught public diplomacy and intercultural communications at Georgetown University and the University of Missouri-Kansas City. He is the author of *Communicating with the World: U.S. Public Diplomacy Overseas*.

²²⁴ http://www.clingendael.nl/publications/2005/20051000_cdsp_paper_diplomacy_5_gonesh_melissen.pdf

²²⁵ Idem 12

²²⁶ Idem 12

themselves - freedom, security and prosperity - are the same ones that Member United tend to promote abroad"²²⁷.

British Council's Strategic Public Diplomacy defines this notion as "*activity that aims to positively influence, including by establishing relationships and partnerships perceptions of individuals and organizations abroad on UK*"²²⁸.

John Nye designates a new concept in diplomacy, soft power, which, according to his definition, is the ability to achieve the expected goal based on voluntary participation by allies, not by constraint. Soft power consists in culture also political ideals of the country. *When you fail to make others admire your ideals also to want what you want. Seduction is always more effective than coercion, and many values like democracy, human rights and individual opportunities are deeply attractive*²²⁹. Soft power of a country is created by the multiple actors and organizations impacting on foreign public - artists, art galleries also broadcasters, NGOs, political parties, writers, musicians and creative associations, journalists and media groups, researchers and teachers, entrepreneurs and religious leaders.

Public diplomacy plays an important role because the spread of democratic political regimes is characterized by the continuous pressure on politics society by transforming the legitimacy of government policies in a key internal stability. In order for democracy to work, it is important that the public be positive, that international organizations must be well-seen by as many citizens from different countries. Globalization offers states the opportunity to have access to foreign investment, in labor from other countries, they can do business in other places, being able to benefit from the economic rules of the state in which you wish to work. Besides this possibility that mainly refers to companies, technology so advanced, the Internet, makes information reach very quickly any part of the world, which creates a transnational public opinion. In this new conjuncture there is no clear delimitation between internal and external policy issues, since, for example, the political crisis in a State may destabilize the international situation.

In this sense, public diplomacy has become an indispensable component of foreign policy of states, but also a topic on the agenda of international organizations. In the London Times newspaper in January 1856, the term "public diplomacy" was used to refer to the need to change U.S. President Franklin Pierce discourse from Britain. During World War I, with reference to the term public diplomacy was used also the term *open diplomacy*²³⁰.

Contrast to diplomacy (official), which could be described as how states communicate with each other, at different levels, public diplomacy focuses on how governments communicate with citizens of other states. It has a transparent character and involves a large number of actors gathered around a common set one interest, unlike diplomacy, which is promoted by institutions. Although, as we know, communicating with the company state that is accredited, has always been the prerogative of the diplomat²³¹. A condition for carrying out an more effective and efficient diplomacy is attractive ideas and the values promoted by a State within its own society. At present, most of the ideas on a country by foreign public assimilated into the areas which are not under the strict supervision of state institutions, books, TV programs, internet, movies, etc. produced by national connotation. In this case, governments can only find ways to positive messages to reach target groups, government programs although experience with shows this many failures and we give as an example the situation of Gypsies in various European countries.

Initially, the term "public diplomacy" was used as an antonym of propaganda²³². While propaganda is usually seen as something malefic, "public diplomacy" is based on the principle of "truth", formulated by the former director of the U.S. Agency for News, Edward Murrow, as follows: "*Truth is the most good propaganda and lies - the greatest evil. To be credible, we must be honest.*"²³³

²²⁷ Reinhart Kosselck concepts and their histories, semantic and pragmatic socio-political language, translated from the German by Gabriel H. sores, ART Publishing House, Bucharest, 2009, p 89

²²⁸ Joseph S. Nye. Soft Power: The Means To Success In World Politics by (Paperback - April 26, 2005) p 72

²²⁹ Idem21

²³⁰ Woodrow Wilson, *Europe and Euro-Atlantic Integration*, ed. Oxford Portland, 2003, pp.110-112

²³¹ Mark Leonard. Public Diplomacy, Catherine Stead, and Conrad Smewing (Paperback - Jun 17, 2002) p 53

²³² Jarol B. Manheim. Strategic Public Diplomacy and American Foreign Policy: The Evolution of Influence (Paperback - Sep 1, 1994) p. 93.

²³³ Idem 23

Thus, depending on the situation public diplomacy can be perceived as a means of propaganda or propaganda can become a means of public diplomacy. The former U.S. ambassador to Syria and Algeria, senior adviser at the State Department Public Diplomacy, Christopher Ross, has identified seven "pillars" or principles of public diplomacy²³⁴:

1. Ensuring the understanding of foreign policy audience as it is in reality, not as others say or think.
2. Need for policy explaining, demonstrating and justifying the rationality of its fundamental values.
3. Submission of appeals consistent, accurate and convincing the international community.
4. The ability to adjust the target audience calls whose constituents are studied continuously.
5. Carrying out the activities not only target narrow segments, and by means written and electronic media oriented masses.
6. Cooperation with various partners to include new representatives from the target audience.
7. Active international communication and exchange programs.

The history of the concept of scientific diplomacy has its beginning in 1941, when Charles Galton Darwin (grandson of Charles Darwin) was appointed by the British Government Central Scientific Director of the Washington Office, in order to collaborate with scientific institutions in the U.S. and facilitate the exchange scientific information²³⁵. However, the Second World War and the use of the atomic bomb led to a greater involvement of scientists in international business management. On 9 July 1955, Bertrand Russell and Albert Einstein published a manifesto which advocated that scientists use all means to neutralize the threat of political persuasion produced by nuclear weapons. As a result, in 1957 there was the first Pugwash Conference on Science and Issues in the World²³⁶. Today the board at Pugwash are considered to be an important platform for discussion on non-proliferation, international security, arms reduction, obtaining, in 1995, in recognition, the Nobel Peace Prize²³⁷. Other organizations that have influenced the development of scientific diplomacy, we can mention the North Atlantic Treaty Organization (NATO), which established in 1957 a program for scientific cooperation.

The EU accession has led candidate countries to rethink external image while efforts are needed to convince their societies need to adopt European standards and fairness course taken. During 2000-2004, the countries of Central and Eastern public diplomacy mechanisms applied in parallel with negotiating treaties of accession to the EU, including Romania.

Using scientific cooperation to improve bilateral relations between countries may take the following forms:²³⁸

1. Scientific and technical cooperation agreements, which often signified improving political relations between countries like USA, USSR and China in the years 70-80.
2. Creating new institutions - eloquent example in this respect is the European Organization for Nuclear Research, which was created after the end of World War II to rebuild trust between countries.
3. Educational grants are considered to be a mechanism for networking verified and encouraging partnerships.
4. Diplomacy "second level" poatefi used to involve experts from outside the official process of negotiations. For this process to be effective, experts involved must be credible and influential, and their findings compelling the parties to negotiations or mediation.
5. Science festivals and exhibitions are considered successful forms of emphasis on the universality of science and common cultural interests.

²³⁴ Christopher Ross, Pillars of Public Diplomacy: grappling with international public opinion, (Perspectives), Harvard International Review, 2003, www.harvardir.org/articles/1117'1

²³⁵ Charles Wolf Jr., Brian Rosen, Public Diplomacy. How to Think About and Improve it, translation Adrian I. Marinescu, Humanitas Publishing House, Bucharest, 2009.

²³⁶ Dizard Jr, Wilson. Digital Diplomacy: U.S. Foreign Policy in the Information Age, Prager, NY April 2010 p.5

²³⁷ Idem26

²³⁸ World Science Forum 2013. Materials of the Session on Science Diplomacy, http://www.culturaldiplomacy.org/youngleadersforums/index.php?en_cde_about-forum

From the examples outlined above lies the fact that, in the modern period, scientific diplomacy contribute to the foreign policy priorities, sometimes creating the necessary conditions to relaunch bilateral relations between states.

Case study / analysis of Romania's integration into NATO

Why NATO integration? In post-revolutionary period, the major objective pursued constantly and consistently by all governments of Romania and the consensus of all political parties and has received overwhelming support of the population, was the objective of joining the NATO and security integration in the north-Atlantic. This goal meant more than a goal Romanian diplomacy agenda. It represented a clear option of returning the country to the family of European democratic values and Euro-Atlantic and change Romania's image abroad. It meant security, meant even the option for economic prosperity and the accession was the most successful post-revolutionary political Romania, together with moment integration into the European Union.

In diplomacy, communication arts, oratory, determines a functioning relationship that develops between layers shall be maintained. Both internationally and regionally, dialogue contributes to peace, political stability, which leads to economic development. To support security policy cooperation led to the prestige enjoyed by the EU today, which major influence European public opinion and the international.

Despite the fact that in 1989-1990, Romania has faced serious problems of national strategy, civil disorder and restore peace after a long difficult period of communist oppression in marie 1990, Romania was the first country coming from the communist bloc which with a strong diplomacy, established official relations with the European Community. In Romania the communist period was the secret diplomacy. It was cultivated as a science and exercised by a small group of people, who were carefully selected, both professional principles and of belonging to the noble family tree²³⁹.

With Melescanu's foreign minister at the time and the government, in 1993, Romania has concluded a European act that allowed our country to become a part of the EU associated countries, and on the other hand to start accession negotiations with the other 11 states.

Romania's accession to NATO was a goal that has enjoyed a broad consensus on the part of all political forces and public opinion. Of the seven invited to join NATO at the Prague Summit, the goal accession enjoyed popular support in Romania highest. In this context, Romania pays special attention to public diplomacy activities in order to maintain and enhance interest and public support for NATO. Better information and knowledge in the public activities, profile and allied structures, a constant process of evolution and adaptation of the Alliance to new security threats and profiling and Romania's role in NATO and its contribution to the achievement of the alliance of goals is essential in this regard. The range of public diplomacy activities include a variety of instruments, from the organization of study visits and information at the Alliance for participants from Romania, seminars, conferences, roundtables, exhibitions on themes that responds Romanian public interest to NATO activities and bring it closer alliance. In organizing these events, Permanent Delegation closely cooperates with NATO Public Diplomacy Division, civil society representatives, academics and university in the country government institutions²⁴⁰.

In the public diplomacy events in Romania, about NATO, a special place has "NATO's Day". This special day is a milestone event for the Romanian society from the perspective of Romania's NATO ally status and meaning associated with this time. Since 2005, "NATO's Day" in Romania is marked annually on the first Sunday of April, based on legislative decisions. When selecting the date, it was taken into account the proximity of the official date of Romania's accession to NATO (March 29, 2004) and the date when the Romanian flag was officially stramed at NATO headquarters in Brussels (April 2, 2004)²⁴¹. "NATO's Day" is a public holiday dedicated to the spirit of democracy and European and Euro-Atlantic area.

Besides the interest in informing the internal public opinion, Romania pays attention and supports the public diplomacy activities of NATO partner countries.

²³⁹ Mircea Malita, *diplomacy, schools and institutions*, the revised second edition, Didactic and Pedagogic Publishing House, Bucharest, 1975.

²⁴⁰ Jozef Batora, *Public diplomacy in small and medium-sized countries: Norway and Canada*. Oxford 2008, p 112

²⁴¹ www.europa.eu

The first NATO product of conceptual evolution of post-Cold War was the Strategic Concept presented at the NATO Summit in Rome in 1991. Moreover, the document that presents the "operational" NATO's founding treaty provisions in the security environment of the '90s, is the first exercise of public diplomacy in the Alliance.

In my opinion, public diplomacy has a multiple role on the international scene such as to facilitate international and interstate cooperation, to streamline decision-making mechanisms, to coordinate the states' position and last, but not least to expand economical, political, military capacity of some countries in order to outline some interests.

Mutual respect is a key element in diplomatic activity and leads to negotiation, collaboration and trust, absolutely necessary attributes between international organizations and the cause of peace and security in the world.

Development of cultural relations and diversification of cooperation have led to specific means of making diplomacy. In addition, MFA cultural agreements, organizations and domestic institutions plus international organizations with a governmental and non-governmental character, which is concerned with universal heritage and sign agreements that facilitate cultural exchanges such as UNESCO. In Article 1 of the Charter of UNESCO, says that in order to achieve this, "*the organization promotes mutual knowledge and understanding between nations, prints a vigorous impulse popular education and dissemination of culture, helps to maintain and dissemination of knowledge.*"²⁴²

Although the idea of stability promotes cooperation and communication, the ultimate goal being the balance of power, in my opinion, this goal remains often promoted by those who are at the top. Thus reinforces my idea that the firmness of United States in defending internal affairs, the inadmissibility of intervention in the economic or military affairs with whom the U.S. worked with, its diplomacy's pragmatism and reluctance which has made certain alliances.

Collective security offers no guarantee to a nation, does not include the idea of threat to the opponent, but defends international law in an abstract way. The obligation to obey rules when a country is part of an alliance is ahead of the national interest. Collective security contributes to the dominance of a safe environment if they share similar ideas in a certain problem: "*...when there was a balance of power were the longest period of peace in history. When a nation becomes infinitely strong competitor in relation to its potential, then appeared the danger of war.*"²⁴³ Nixon, Time Magazine, January 3, 1972.

Although Charles de Gaulle stated that "*Diplomats are useful only in fair weather. How begins to rain gets drowned in every drop*"²⁴⁴, despite some high-level diplomacy failures, as were Wilson, FD Roosevelt or Truman, with other heads of state, though the importance of these meetings to create communication channels was evident in subsequent crises.

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²⁴² Angela Duțu, UNESCO Documentary, Politehnica Publishing House, Bucharest, 1973.

²⁴³ Henry Kissinger, Dplomația, All Publishing, Translation from English, Mircea Radu Ștefancu and Paraschivescu, Bucharest, 1998.

²⁴⁴ Thomas A. Bailey, The Art of Diplomacy, The American Experience, New York, 1968, page 16

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THE VIABILITY OF ISSUE RECONCEPTUALIZATION IN THE ARAB-ISRAELI CONFLICT

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Abstract:

The Israeli-Palestinian conflict is one of the most notorious intractable conflicts of the century. Historically, two streams of thought have dominated the academic realm of conflict resolution and reconciliation efforts: those which focus on reconciling final status issues, and those which focus on reconceptualizing identity. However, what has been neglected is the relationship between the two, or how identity affects individual's perspectives on final status issues. As such, I propose that through re-conceptualization of issues, perspectives can be altered in such a way so that final status issues are no longer viewed as zero-sum. Such a re-conceptualization subsequently lays the foundations for more effective reconciliation and resolution efforts as both sides can envision potential gains. While this in itself is not an all-encompassing solution due to the dynamism of the conflict, when used in conjunction with other methods it provides yet another opportunity for open discussion and debate concerning resolution and reconciliation.

Keywords: Israeli-Palestine, reconceptualization, psycho-social, reconciliation

Introduction

The Israeli-Palestinian conflict is one of the most notorious intractable conflicts of the century. Historically, two streams of thought have dominated the academic realm of conflict resolution and reconciliation efforts: those which focus on reconciling final status issues, and those which focus on reconceptualizing identity. However, what has been neglected is the relationship between the two, or how identity affects individual's perspectives on final status issues. As such, I propose that through re-conceptualization of issues, perspectives can be altered in such a way so that final status issues are no longer viewed as zero-sum. Such a re-conceptualization subsequently lays the foundations for more effective reconciliation and resolution efforts as both sides can envision potential gains. While this in itself is not an all-encompassing solution due to the dynamism of the conflict, when used in conjunction with other methods it provides yet another opportunity for open discussion and debate concerning resolution and reconciliation.

Main Text

Identities are of pivotal importance because they allow individuals to situate themselves within, and understand their relation to, the wider world. Identity is constructed and maintained in two ways: by an individual's interactions with others, and through membership in reference groups. According to Cooley's concept of the 'Looking Glass Self', the bulk of an individual's self-identity is developed based on social interactions.²⁴⁵ This becomes an important fact to remember when studying intractable conflicts, as negatively-perceived interactions between two opposing groups undoubtedly contribute to the conflict's perpetuation. Secondly, reference groups – groups defined by similar worldviews, characteristics, and/or values – offer individuals the opportunity to ascend past individual self-identity and towards a collective group identity.²⁴⁶ Reference groups can be formed on virtually any basis – ethnicity, nationality, religion, gender, etc. – and thus often intersect and overlap, for so long as two reference groups are not in direct opposition to one another - necessitating oppositional

²⁴⁵ Elbedour et al., "Identity Formation in the Shadow of Conflict: Projective Drawings by Palestinian and Israeli Arab Children from the West Bank and Gaza," 219

²⁴⁶ Shibutani and Rothman, from *Ibid*

definitions - an individual can ascribe to a variety of reference groups.²⁴⁷ Due to their exclusivity, reference groups inherently create 'in-groups', those who are part of the specific reference group, and 'out-groups', those who are not. In situations of conflict, the out-group is typically vilified and delegitimized.²⁴⁸

Perhaps most importantly, membership in a reference group provides an individual with a specific 'collective narrative', i.e. a way to understand the world in a meaningful, organized, and predictable way.²⁴⁹ Existing outside of a linear time frame, they aim to tie "...at least two real or fictive events or situations in [a] time sequence, neither of which presupposes or entails the other."²⁵⁰ In simpler terms, collective narratives attempt to identify themes within real-world events which explain and bolster the reference group's understanding of the world. Presented through popular culture (e.g. television), myths, rituals (e.g. holidays), and biased accounts of specific events,²⁵¹ collective narratives shun ambiguity, focusing instead on "...enduring beliefs shared by society members..."²⁵² For example, the 1948 war is understood very differently by the Israelis and the Palestinians. Known as the 'War of Independence' by Israelis, in Israeli school curricula the Arabs are established as the aggressors and there is little (if any) mention of the Palestinian refugees created as a result. Oppositely, the Palestinians understand The Catastrophe (*al-Nakbah*) as the beginning of a war of aggression against their national identity, and focus heavily on the resulting refugee population the conflict created. Here, the Israelis are depicted as the aggressors and accorded full responsibility for creating the refugee problem.²⁵³

Collective narratives are also dynamic: they do not just re-tell the past, but shape the future by ascribing moral judgments on information/events.²⁵⁴ By assigning a moral judgment (e.g. truth or lie, good or bad), collective narratives directly shape individual/group perception re: specific situations. With this in mind, astute actors can then use collective narratives to individual/group emotions, persuade public opinion, and thus control real-world reactions. In conflict situations, dominant political actors on either side go to extreme measures to ensure that the dominant narrative bolsters their own position and that alternative/counter-narratives are not given any ground to stand on, lest these counter-narratives create or exacerbate existing internal cleavages. Stagnation, inertia, and/or apathy additionally make the in-group's narrative more susceptible to doubts, which also threaten cohesion.²⁵⁵ We saw this behaviour in the previous example of the 1948 conflict: Israelis know the conflict as the 'War of Independence', which evokes ideas of an oppressed minority overcoming seemingly insurmountable obstacles to fight for and win their independence. No mention is made of the adversary's narrative or motivations; they are simply a one-dimensional 'aggressor' against which the justified in-group struggles.

In his 1984 study on Reciprocal Interaction Effects, Kaplowitz demonstrates the interaction between perceptions and reality. He posits that, depending on the capabilities and ideologies of those involved, an actor can strategize a plan which aims to create a specific outcome. In his analysis, Kaplowitz provides five roles which states assume: totalist, long-run totalist, competitive use of force/deterrent-punitive, firm but cooperative, and conciliatory. Each of these roles exhibit specific characteristics; for example, (long-run) totalists believe that only through the annihilation of the out-group can security be ensured.²⁵⁶ He argues that, if the in-group state knows the roles both itself and

²⁴⁷ Elbedour et al. note that "[w]hen two reference groups are in conflict, or competing for the same resource, individuals [define] themselves both in terms of their membership to their own group, as well as in reference to the other group. (220)

²⁴⁸ Bar-Tal and Salomon, *Narratives of the Israeli-Palestinian Conflict*, 8; Aharon Bizman and Michael Hoffman. "Expectations, Emotions, and Preferred Responses regarding the Arab-Israeli Conflict: An Attributional Analysis." *The Journal of Conflict Resolution* 37, no. 1 (1993): 140

²⁴⁹ Bar-Tal and Salomon, *Narratives of the Israeli-Palestinian Conflict*, 2

²⁵⁰ Shaul Shenhav, "Political Narratives and Political Reality." *International Politics Science Review* 27, no. 3 (2006): 247

²⁵¹ Sucharov notes that events which contribute to collective narratives can be active (current), one step removed (e.g. from a past generation), or ancient. (27)

²⁵² Bar-Tal and Salomon, *Narratives of the Israeli-Palestinian Conflict*, 2

²⁵³ Sucharov, *The International Self: Psychoanalysis and the Search for Israeli-Palestinian Peace*, 3

²⁵⁴ Shenhav, "Political Narratives and Political Reality," 250

²⁵⁵ Daniel Bar-Tal et al., "Socio-Psychological Barriers to Peace Making: The Case of the Israeli Jewish Society." *Social Issues and Policy Review* 4, no. 1 (2010): 70-72; Beit-Hallahmi, "Some Psychosocial and Cultural Factors in the Arab-Israeli Conflict: A Review of the Literature," 274

²⁵⁶ Noel Kaplowitz, "Psychopolitical Dimensions of International Relations: The Reciprocal Effects of Conflict Strategies." *International Studies Quarterly* 28, no. 3 (1984): 377

the out-group state ascribe to, as well as the (military/social) capabilities each state have at their disposal, then the in-group can ascertain the tangible costs and benefits, and choose their response accordingly.²⁵⁷ Let us use the example of a conflict involving a totalist versus a competitive use of force/deterrent-punitive: if the totalist is more powerful, she will attempt to overrun its adversary, whereas if power parity exists, the competitive use of force/deterrent-punitive state will most likely drive the totalist force into latency.²⁵⁸ Consequently, the totalist will choose whether or not to attempt to overrun her adversary based on her relative strength to her adversary: yes if stronger, no if weaker.

Thus, we can see the fundamental role that collective narratives play in prolonging intractable conflicts. Created and maintained by dominant societal beliefs, collective narratives shape individuals'/groups' perspectives and influence them toward specific responses. In identity-based conflict, this becomes even more problematic, as each group internalizes a conflict ethos²⁵⁹ - a collective narrative which attributes positive acts to the in-group and negative acts to the out-group - and remains wholeheartedly convinced of the zero-sum nature between the two sides. This zero-sum perspective has inadvertently been ascribed to the final status issues as well, due to the perceived tie between identities and the issues involved.

With this in mind, any hopes of reconciliation between the two sides must include a focus on reconstructing each actor's collective narratives. This can be approached in two ways: A. by delinking the final status issues from identity so that they are perceived as stand-alone events as opposed to a part of a wider narrative; or B. by moving away from the perceived zero-sum status of these issues towards one open to full or partial reconciliation. As touched upon earlier, option A would be extremely hard to implement due to the durability of identities and the difficulty in instigating critical self-analysis on a collective level.²⁶⁰ Therefore, Option B appears to be the more realistic choice, and as such is the my point of focus.

In order to realize Option B several steps must be taken, the majority of which focus on the re-direction of the conflict ethos towards a peace ethos which, scholars hope, will then create conditions conducive to understanding and reconciliation. For this to occur, the first step must focus on the legitimization of the out-group's collective narrative.²⁶¹ In this case, legitimization is not synonymous with internalization: the in-group can objectively understand the motivations and perceptions of the out-group without changing its own collective narrative.^{262 263} However, by recognizing that the out-group's narrative is considered legitimate to the out-group and therefore plays a role in the conflict, the in-group can use this newfound understanding of the out-group to formulate a strategic response, as demonstrated by Kaplowitz.²⁶⁴

Secondarily, a distinction must be drawn between an ideological victory and an operational victory.²⁶⁵ Both sides currently believe they would both be better off if the other did not exist; however, this reality is extremely unlikely to happen in the near future. As such, despite the fact that both sides are ideologically unwilling to sacrifice their hardened positions on the final status issues, they must come to terms with the realistic facts that some type of negotiations are necessary. One way this can be accomplished is by subordinating the respective goals of each reference group to one overarching collective narrative of peace. As previously established, collective narratives are created and maintained by the in-group's social conditions and perceived history. As such, peace movements,

²⁵⁷ *Ibid*, 398

²⁵⁸ *Ibid*, 389

²⁵⁹ Conflict ethos encompass five different roles: the belief in the justness of one's goals; the security dilemma; the promotion of positive collective in-group images; the delegitimization and dehumanization of the out-group; and the promotion of patriotism, social unity, and utopian peace. (Bar-Tal and Salomon, *Narratives of the Israeli-Palestinian Conflict*, 10-16)

²⁶⁰ Bar-Tal, "From Intractable Conflict through Conflict Resolution to Reconciliation: Psychological Analysis," 353

²⁶¹ Bar-Tal and Salomon, *Narratives of the Israeli-Palestinian Conflict*, 19

²⁶² Kelman, "The Political Psychology of the Israeli-Palestinian Conflict: How Can We Overcome the Barriers to a Negotiated Solution?" 362

²⁶³ Examples of this can be found in Rosen (Tigal Rosen, "Transformation of Central and Peripheral Beliefs in the Eyes of the 'Other': Challenges for Peace Education." *Journal of Transformative Education* 7, no. 2 (2009): 140)

²⁶⁴ Kaplowitz, "Psychopolitical Dimensions of International Relations: The Reciprocal Effects of Conflict Strategies," 375

²⁶⁵ Kelman, "The Political Psychology of the Israeli-Palestinian Conflict: How Can We Overcome the Barriers to a Negotiated Solution?" 360

revisionist historians, domestic media, artists, and other actors and/or forms of expression can alter how people perceive their collective narratives.²⁶⁶ We have also established that individuals can belong to several reference groups (and thus adhere to several collective narratives) so long as they do not oppose each other.

This new subordinate narrative must be explicit in what it will and will not provide; another utopian goal which proves to be unreachable would just add yet another intractable factor into the conflict.²⁶⁷ In order to realize this, both Israel and Palestine (represented by the P.A.) must also establish and maintain unwavering support for this superordinate collective narrative. This includes, but is not limited to, accepting external support, putting down domestic opponents to peace, and involving social institutions in re-shaping society's goals.²⁶⁸ It is one thing to preach commitment to peace, but another to actually institutionalize it. Lastly, each group must be willing to look towards the future instead of the past; only by doing so can perceived self-victimization be avoided.²⁶⁹ Creating a superordinate goal of peace does not necessitate the destruction of other collective narratives, but instead adds an additional tier which takes priority over the intractable positions each side currently hold.²⁷⁰ Within their smaller collective narratives, each side can internally believe that they alone hold the 'right' to the land/Jerusalem/to return, so long as peace is prioritized as the ultimate goal for both groups. In this way, common ground can be established and held as neither side will risk any action which may jeopardize this superordinate goal.

However, some drawbacks do exist. First, each society must overcome the belief that forgiving is equivalent to forgetting. At this point, the conflict has become so entrenched into the collective narratives of each respective group that it would not be feasible to expect either side to forget the atrocities committed against them, nor for their respective politicians to ask it.²⁷¹ So long as neither side is willing to admit their faults – and this will continue to be the case so long as material power disparities exist and national identities are perceived to be at stake – true reconciliation cannot exist. What this at best offers, then, is an extended opportunity for peaceful conditions that will hopefully evolve into conditions suitable for reconciliation, given enough time.

Secondarily, the current material power disparities on the ground make it very difficult for the Palestinians to create and maintain the new superordinate collective narrative of peace. In order for the superordinate narrative to become dominant, both the government and civil society must focus on promoting it and suppressing all attempts to deviate away from it. For the Palestinians, this promotion and suppression becomes increasingly difficult: not only does the P.A.²⁷² not have a monopoly on the entire Palestinian territory (since Hamas controls the Gaza Strip), but they also do not currently have the physical capacity in the form of police forces to stem radical behaviour.

This leads us to the third and most controversial issue: the 'chicken and egg' argument of what comes first, material peace or narrative reconstruction. As we have witnessed, establishing material peace without first addressing the underlying tensions surrounding identity issues (i.e. mutual recognition and legitimization) is especially difficult to generate. The Oslo Accords, the most recent attempt at just that, was largely stalled by parties who still internalized the divisions between the two sides and refused to accept some type of compromise.²⁷³ Concurrently, narrative reconceptualization and reconstruction cannot occur while power disparities between the two sides remain so stark. Rothman and Olson note that in situations where resource allocation is unequal between sides – an undisputed fact in the Israeli-Palestinian conflict – traditional methods are often unsuccessful because they do not deal with the underlying effects of structural inequalities. These structural inequalities are

²⁶⁶ Sucharov, *The International Self: Psychoanalysis and the Search for Israeli-Palestinian Peace*, 35

²⁶⁷ Bar-Tal, "From Intractable Conflict through Conflict Resolution to Reconciliation: Psychological Analysis," 359

²⁶⁸ *Ibid*, 361

²⁶⁹ Kelman notes that "[n]o matter how strong interest in negotiation is, no leaders will enter into them under conditions that leave their right to national existence in doubt." (353)

²⁷⁰ Bar-Tal, "From Intractable Conflict through Conflict Resolution to Reconciliation: Psychological Analysis," 357

²⁷¹ Cehajic et al., "Forgive and Forget? Antecedents and Consequences of Intergroup Forgiveness in Bosnia and Herzegovina," 363

²⁷² Despite all of its shortcomings, scholars predominantly focus on the P.A. because it is the only agency that is widely accepted as legitimate, is not under occupation, and is not beholden to foreign powers. (Kelman, "The Political Psychology of the Israeli-Palestinian Conflict: How Can We Overcome the Barriers to a Negotiated Solution?" 352)

²⁷³ Ian Lustick, "The Oslo Agreement as an Obstacle to Peace." *Journal of Palestine Studies* 27, no. 1 (1997): 62

conducive to protracted conflicts because they aggravate the security issues of either side, making each side feel more vulnerable. In turn, this vulnerability leads each side to harden their own positions, lest they put themselves further at risk of having their interests ignored. This results in a negative feedback loop, where neither side will compromise their positions in pursuit of the common good, as it means risking their position all-together.²⁷⁴ Additionally, as mentioned, states who do not hold a monopoly on violence cannot ensure the predominance of the peaceful superordinate identity, which undermines the collective narrative reconstruction.²⁷⁵ Therefore, we once again are introduced to a seemingly intractable situation where both methods of resolution and reconciliation require the other to be implemented first in order to ensure their success.

Conclusion

The Israeli-Palestinian conflict is a complex, multi-faceted issue which concerns a variety of overlapping issues, including those of both material distribution and identity. In this paper, I have attempted to introduce an additional method for creating conditions suitable for establishing resolution and reconciliation: the reconceptualization of final status issues. In my proposal, I have attempted to mesh these two considerations together by asserting that a reconceptualization of final status issues, so that they are not perceived as zero-sum nor associated with national identity security, may provide additional room for common ground to be found.

In closing, I would suggest that both material peace and narrative reconstruction should be pursued simultaneously. This will allow the flexibility necessary for the Palestinians to establish stronger domestic institutions, and for both sides to warm to the idea of compromise for the sake of peace.²⁷⁶ The reconceptualization of final status issues will assure both sides that their national identities are not in jeopardy, thus prompting them to enter into negotiations and make compromises, as these would no longer be synonymous with the eradication of their identities, thus providing an opportunity for common ground and positive steps forward to be established. While reconceptualization is not an exclusive solution to the peace, it does offer an additional perspective that may be successfully employed alongside other measures.

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²⁷⁴ Rothman and Olson, "From Interests to Identities: Towards a New Emphasis in Interactive Conflict Resolution," 293

²⁷⁵ Rowley and Webb, "Israel and Palestine: The Slow Road to Peace or the Fast Track to Mutual Annihilation?" 11

²⁷⁶ Sucharov notes that the stronger party (namely Israeli) has no real incentive to change the status quo because, aside from a collective narrative of their underpowered neighbours, Israeli citizens are generally not directly affected by the conflict. (2)

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DEMOCRACY IN THE CONTEXT OF MATERIAL SHORTAGE IN NIGERIA'S FOURTH REPUBLIC: LIMITATIONS AND THE WAY AHEAD

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Abstract:

Virtually all modern independent States have as their fundamental goals the pursuit of the welfare and well-being of their citizens. To achieve these goals, the Nigerian State is required to harness its huge human and material potentials for the development of the country. This encompasses increase in employment generation, and improvement in literacy and health status as may be found in longevity and social stability. For several decades all these could not be realized due to bad governance under militarily authoritarian rule. With the inauguration of civilian rule in 1999, it was expected that democratic rule will stem the tide of economic decline and socio-political instability. Over a decade the country is still groaning under socio-economic and political miseries. With the use of political participation theory, the paper argued that the only practical way to surmount the present material shortage is to empower a person to make informed choices and contribute actively in making public decisions which affects their welfare and well-being to recreate their environment and unleash their innate potentials for self development and corporate co-existence. All these involve breaking with the tragedy of the past and increasing the likelihood of achieving the goals of a wealthier, healthier and better educated citizenry under democratic rule.

Key Words: Democracy, Materialism, Nigeria, Fourth Republic, Politics

Introduction

The return to civil rule in Nigeria after years of military and authoritarian rule, raised expectations for a possible resolution of the hydra-headed socio-economic crisis bedeviling the nation since flag of independence in 1960. Socio-economic development did not fair well under military/authoritarian rule in the country. The military that had no experience in governance when they first took power in 1966, gradually settled down in government, no thanks, to their prolong stay in political power. Yet, this failed to translate into consistent socio-economic and political development as the economy move from one crisis to the other. Austerity measures were introduced in the late 70s after years of mis-rule by General Gowon. As the economic condition of the country worsened, Structural Adjustment Programme (SAP) was introduced under the kleptocratic regime of General Babangida in the late 80s and early 90s. These years were characterized by mal-administration, mis-management of resources, mal-development and mal-integration in the country.

The clamour for democracy by its founding fathers was predicated on certain universal goals and values which are capable of promoting human welfare and well-being. These core values of democracy include: freedom of speech, conscience and their correlate, liberty and fraternity. Where these values are properly activated, they lead to effective empowerment and mobilization of the people to participate in socio-economic and political decision making and development. However, this has not been the case in Nigeria. Consequently, the country has had to contend with a debilitating cycle of political decay and renewal. Yet, with the return to civilian rule in 1999, nothing seems to

have changed. The Fourth Republic political elite appear to have learnt and forgotten nothing of the despicable practices of previous Republics.

They appear to have lost the initiative in tackling the socio-economic and political malaise plaguing the nation's polity. This explains the deplorable state of different sectors of the economy. Virtually all sectors of the economy are at varying stages of decay. The expectations that the return to civil rule will stem the tide of socio-economic decline and deliver the dividends of democracy therefore, have largely been unrealized. This brings to the fore the apt question: can there be democracy in the context of material shortage in Nigeria? Can the country's economy midwife democratic consolidation? The discussion that follows attempt to address this and related issues.

To discuss issues raised, the paper is structured as follows: the First section discussed the conceptual and theoretical orientations of the paper. The second, engaged in an overview of Nigeria's political –economy, the third discussed the socio-economic performance of the country under civil rule since 1999. The fourth, analyzed challenges facing the country in its effort to deliver good governance. The fifth suggest ways forward for the nation and its people and then conclusion.

Conceptual and Theoretical Considerations

Democracy is regarded as the best form of government because of opportunities it avails its adherents to govern themselves and uplift their material and physical conditions. Democracy therefore, can be seen from two levels. The first, perspective views democracy as a moral imperative. This imperative, in the words of Nzongola-Ntalaja (1997) is “a permanent aspiration of human beings for freedom for a better social and political order, one that is more human and more or less egalitarian”. This social and political order is necessary for the people to realize their goals. In the second perspective, democracy is seen as a social process. In this case, democracy aims at “radically changing the deteriorating situation to bring improvement in the material life of the people” (Nzongola-Ntalega, 1997).

While the ideal type democracy may not be feasible in this modern times due to increase in population, Dahl (1971) suggests that the next possible alternative to it is Polyarchy. He refers to Polyarchy as “administrations that have been substantially popularized and liberalized, that is, highly inclusive and extensively open to public contestations”. The reference to citizens' participation underscores the relevance of the people's welfare and well-being to democratic rule. Democracy is able to harness and release the potentials of the people to make important decisions which affect their lives. In the process they exercise power however, small or symbolic (Ake, 1994).

As citizens participate in political affairs in a democratic system, the more they become democratized. Democratization can be viewed from two broad perspectives. From a narrow angle, democratization means, “a stage in the creation and maintenance of democracy”. This process entails the movement from the old (authoritarian) administration to the establishment of new one (Levine, 1989). From a broad perspective, democratization is seen as the creation, nature and spread of more egalitarian social relations and norms of leadership and authority (ibid). In both perspectives, democratization entails extending the norms, procedures and mechanisms of democracy (Gerraton, 1997).

The end product of democracy is development. Development is a multi-faceted concept that has experienced shifts in its paradigm. Beyond commodity fetism, development now embraces “...broad-based growth, employment generation, and steady improvement in literacy, and health status implicit in longevity and social stability” (Iwayemi, 2001). It is further argued that “development is about change that results in sustained improvement in the general well-being of people in the society” (ibid).

All these processes create tangible material context on which the people can live and actualized their potentials. The better context that development creates is epitomized in “...rising income per capital, better education, better health, increase in life expectancy, full employment, and

social stability” (Iwayemi, 2001) especially in a developing societies. All these help democracy to be depended and the citizenry better able to make informed choices and decisions.

Several theoretical platforms could prove heuristic for analyzing issues germane to the study. Some of these include: Ekeh (1976) theory of the Two Publics, Ake (1981) political economy theory, Dudley (1987) State-society relations theory, Huntington (2001) political institutionalization theory, to mention few of them. In the pursuit of the core values of democracy as captured in our conceptualization of democracy, political participation theory comes out forcefully. While political participation could be seen as means of reaping the reward of holding political offices, others see it as avenue of affirming one’s efficacy in the political system. In the view of Lipset (1960) it offers “...opportunities for changing the governing officials and a social mechanism which permits the largest possible part of the population to influence major decisions by choosing contenders for political office”, ensure they are politically accountable and in the process promote good governance. All these are central to achieving the peoples’ material ends. But this is not always the case because in representative democracy, the elected them to dominate the electors.

Understanding the Nigerian Political Economy: An Overview

In Africa, the pre-capitalist economic arrangement before the advent of the British Colonial Administration was largely agrarian. Art and craft, trans-Atlantic slave-trade and commerce were the other dominant occupations. The exposure of Africans to European trans-Atlantic traders brought to the fore foreign commercial interests who dominated and consequently sidelined craftsmen and peasant producers. Agriculture was the main-stay of the rural economy. It employed over 70 percent of the rural inhabitants, besides providing food for over the same number of people. Under colonial rule, it was the chief revenue earner for the country. However, before long, imperialist domination of the pre-capitalist mode of production aided capitalist penetration and the development of its forces of production.

The incorporation of Nigeria into the world capitalist order led to the development of its forces of production. But this has been carried out not in ways that favours craft making and commercial agriculture, on the contrary it has grown in ways which met the requirements of commercial capitalism. Thus, the development of indigenous capitalism limited the development of peasant production (Williams, 1980). Unfortunately, Nigeria lacks the essential conditions which produce and promote indigenous capitalist. Attempts by the state to do this have led to:

Shifting resources from more competitive to less competitive producers, from craft to factory production, from agriculture to industry, from rural to urban areas, from the poor to the rich, and from the Nigerians to foreigners. It has hardly given free rein to the ability of people to produce goods. It has promoted the wealth of the nation, but only by the impoverishment of the people (Williams, 1980).

The capitalist model introduced into Nigeria’s economy distorted the pre-capitalist mode and forces of production to the extent that Nigerians have lost the initiative in organizing and directing their economic development from within. More often than not, economic policies are either received from Europe and America or fashioned along development in the capitalist or ex-metropolitan countries.

The shift from agriculture to oil has not altered the structure and orientation of the economy. Oil that was first discovered at Oloibiri in the present day Bayelsa State, now accounts for over 90 percent of the country’s foreign exchange earnings. However, the way and manner oil is explored and exploited has not improved the lot of Nigerians rather they have led to comprador capitalism and a rentier economy. The state relies on oil rent to survive. Graf (1998) characterized such economy as rentier, the features of which:

...is that it severs the link between production and distribution, revenue accrues from productive activities. This production depends, however, on techniques, expertise, investments and markets generated outside the territory controlled by the state. For this reason practically all aspects of exploration, production and marketing are dominated by international capital, typically in the form of the multinational corporations.

The transition from agriculture to oil economy has not changed the pattern of trade relations with the West. The implications of this structure of the post-colonial economy on Nigeria can be summarized thus: the economy is susceptible to crisis and shocks in the prices of commodities in the World Market, the economy is dependent on South-South trade patterns, it disarticulates the economy, discourages agricultural development and vitiates the growth of non-state capitalism. Also, these factors mitigate against the state's autonomous action and has led to the externalization of efforts to arrest the economic decline in the country, (Osaghae, 2002).

Politically, the concentration of oil revenue at the center or federal level has made the state very attractive to different groups and power centers within the federation. The premium on power has become very high and competitive party politics has taken a zero-sum approach where the winner takes all and the loser is vanquished. This has led to intemperate political behaviour that sometimes translates into political thuggery, assassination, ballot box snatching and stuffing, among others. Tendentially, the country is inherently unstable as different parts of the country are under siege either by militants, kidnapers, and or ethno-religious insurgency. The most recent and attritions of them is the Boko Haram sect terrorizing some parts of Northern Nigeria.

Nigeria's Political Economy under the Fourth Republic

The return to civil rule in 1999 raised hope for an improvement in the economic situation in the country. All sectors of the economy came under review. A new philosophy and orientation was encapsulated in a document called The National Economic Empowerment and Development Strategy (NEEDS). The document lays out the policy thrust of government which is aimed at re-directing and re-focusing the economy for the challenges of an ever competitive and complex global order. NEEDS is "to create a Nigeria that Nigerians can be proud to belong to and grateful to inhabit, a Nigeria that rewards handwork, protect its people and their property and offers its children better prospects, than those they will attempt to seek in Europe or the United States" (NEEDS, 2004). To achieve its vision, it focuses on four key strategies "re-orienting values, reducing poverty, creating wealth and generating employment (ibid).

Implementation of these strategies began with efforts by the central government to repay and reschedule some of the country's debts. To this end, in 2005 and the early part of 2006, the federal government successfully paid \$12.4bn to the Paris Club of creditors nations to earn \$18bn write off of the outstanding \$30bn debt owed the group" (New Age, 2007). The repayment and rescheduling of the country's debts, it would seem, was to provide soft landing for the government, to buy the favour of the international financial institutions in the country's drive to resuscitate the ailing economy, and create window for further loans and assure of liberalization of the economy.

The electricity power sector is one aspect of the economy that received and is still attracting the attention of government. In a bid to increase the country's power generating capacity, the government envisaged that by 2007, it will increase its present generating capacity put at about 3,000mw to 10,000mw. To this end, the government has sunk about ₦18.6bn into the power sector. While the government is encouraging the participation of Independent Power Producers (IPP) in the electricity industry, it has embarked on the construction of new thermo power stations across the country (Reforms of the Power Sector, 2004).

Another sector of the economy that has received major attention from the federal government in the period under consideration is the oil and gas sector. The government has made efforts to bring

into full operational capacity, the four refineries in the country. It has sunk billions of Naira into the turn around maintenance of this vital sector of the economy, to ensure smooth supply of petroleum products in the country that is one of the world's leading producer of oil and gas products. But the oil industry has turned out to be a hard nut to crack. The enormous resources sunk into the sector have not reflected in its domestic prices and efficiency and effectiveness in service delivery.

Although, agriculture has taken the second place in the priority of government, it occupies an important position in the life of the nation. This is why successive governments have given attention to this sector. Government has been making serious efforts to increase production of basic staple food items in the country such as rice, wheat, sugar, beans, cassava, among others. This is not unconnected with the increase in the prices of these staple food items which serve as major sources of protein to Nigerians but whose prices have sky rocketed since the return to civil rule. Also the fear of food crises in Nigeria remains pervasive. The country now relies on import to meet its local demand for rice, beans, sugar, etc.

Table 1: The Cost of three staple food items: Rice, Sugar and Wheat Flour

Year	Rice	Sugar	Wheat flour
2006	₦4,000	-	₦2,900
2007	₦6,000	₦4,800	₦3,200
2008	₦10,000	₦5,500	₦5,000

Source: Tell Magazine May, 2008.

To cushion the effect of decline the in production of staple food items, government has embarked on frantic importation of food items hitherto produced in large quantity in the country. For example, in four years, Nigeria spent about 47.88 billion dollars on importation of consumables (Odion-Akhaine, 2008).

Democracy in the Context of Material Shortage: Challenges and the Way Forward

A strong correlation has been established between economic performance and democratic consolidation. As Diamond (1999) posits:

It is by now a truism that the better the performance of a democratic regime in producing and broadly distributing improvements in living standards, the more likely is to endure.... While the level of economic development powerfully shapes the survival, prospects of democracy and affluence democracies survives no matter what, among moderate income and especially poor countries, democracy is much more likely to last when the economy grows rapidly and with only moderate inflation.

If the above claim is anything to go by, then Nigeria is still groping in the dark. The expectation that the return to civil rule will stem the tide of economic decline has not been met rather at the macro-social level, poverty, unemployment; lack of social infrastructures have been on the increase. Poverty is on the increase in the country as over 65% of Nigerians are poor. And if Huntington (1991) view to the effect that poverty is the principal obstacle to democracy is anything to go by, then democracy is certainly not being consolidated in the country.

The reason for this claim may not be unrelated with the failure of government at the center to carry out its annual budgets efficiently and effectively. As members of the Nigerian Parliament in Nigeria recently lamented, by the month of July 2012, funds have not been released to ministries, departments and agencies (MDAs) to carry out capital expenditure. In the view of some members,

these bodies were being starved of funds by the non-release of funds to them by the ministry of finance. It contends that while “recurrent expenditures have kept pace with expectations, the capital budget implementation is suffering” (The Nation, 2012).

Currently, the people’s conditions are in a very sorry state. Essential commodities are priced out of the reach of the ordinary Nigerians who earn ₦18,000 per month in some states of the federation as minimum wage – a take home pay that cannot take many home – can only result in material shortage: hunger, desperation, crime and the likes. Indeed, hunger has intensified over the years. According to the report of the United States based ‘International Food Policy Research’ and a German Non Governmental Organization “Agro-Action” Nigeria ranked 40 out of 119 developing countries on the global hunger index (The Punch, 2006). Similarly, the human development index 2006, ranked Nigeria as 117th out of the 140 countries in the quality of life index (The Punch, 2006).

The declining material conditions of the people under a supposedly democratic system throws spinner in the wheel of the democratization process in the country and is gradually alienating the people from their government with devastating effect on the legitimacy of the government and its agencies to act which means that it will have to rely on force to get its decisions and actions carried out. Inability of government to pursue the public interest has serious implications for the sustenance of democracy. As Laski (1921) persuasively argues:

.....a state which refuses to me the things it declares essentially to the well-being of another is making me less a citizen. It is denying that which invests its power with moral authority. It is admitting that its claim upon me is built not upon its ethics, but its strength.

Democracy endures not by the use of force but the good will of its citizens. The neo-liberal market reforms in Nigeria have extended rather than bridged the gap between the rich and poor in the country. This inequality is promoted by the rentier economy propelled by the oil cabal who feeds on distribution of oil wealth rather than its production. The stark revelation about the running of the oil industry shows that revenues from oil find their way into the hands of comprador capitalist in the private and public sectors with active connivance of the oil multi-nationals.

All these developments feed into the political space in the country that has become expectedly tense, insecure, and winner –takes-all. Politics of impunity has become the order of the day because the stakes are high and politicians will do anything to lay their hands on the national cake. Institutional rules in the process become the first causality as they are observed more in their breach than observance. In all these, the social concerns of the citizenry are given scant attention to by those holding political and economic powers. This is reflected in the rapidly decreasing standard of living across the length and breadth of the country. These challenges, as enormous as they might seem, are not insurmountable. In the section that follows, we shall proffer some steps which might take the country out of this quagmire.

Democracy in the Context of Material Shortage: The Way Forward

The greater part of the country’s post independence years were spent under authoritarian rule. The present democratic experiences present the country with another auspicious chance of institutionalizing democracy and an egalitarian society. Given the country’s pedigree of government by compulsion or force “State power which seems consistently to favour particular interest at the expense of others not only forfeits the support of the excluded interests but also undermines the legitimacy of its own claims to authority” (Williams 1980). There is need therefore, for transformational leadership to bring forth a new political ideologyunder which all can contribute to the concerted match to orderly progress and in which public objectives are taken out of political contention, (Williams 1980). Its socio-economic and political ideology should embody public goals and values not parochial interests.

The country is in dire need of statesmen “whose minds are elevated sufficiently above the conflict of contending parties to enable him/her to adopt a course of action which takes into account a great number of interests in the perspective of a longer period of time” (Magstadt, 2006). It is only leaders with extra-ordinary political skills and practical wisdom that can resolve the hydra-headed socio-economic challenges facing the nation.

The answer to the poverty question and other social malaise in the country lie in government efforts at unlocking the “welfare of the individual through providing better educational facilities, housing, health facilities, more jobs and rising standard of living for the people as a whole (Williams, 1980). These goals might be difficult to achieve under a neo-liberal market reform with its high social cost (Olukoshi, 1998). State managers should therefore come up with innovations which will incorporate the country’s own values and goals into its home grown socio-economic system.

This will require mobilization of the populace to take active part in sustaining this “new” socio-economic model for the country. In this regard, broader consultation should be made with Community Based Organizations (CBOs), People’s Organizations (POs), Voluntary Organizations (VOs) among others, to evolve a system that will take a bottom-top approach that will bring to the fore a truly indigenous development paradigm into the socio-economic system in the country.

The immediate outcome of such measures could easily be imagined. It will bring about diversification of the economy and a shift from the reliance on oil as the chief revenue earner of government. Other veritable sources of job creation and resource generation would be revived. The agricultural sector will be properly linked with the urban industrial sector to ensure that rural produces are not allowed to rot away due to low patronage from the urban areas. Such linkages will boost agricultural production as farmers would be assured of patronage and in the process stem the tide of rural – urban integration. More jobs would be created and production of goods and services would be increased.

In a democratic system, political parties are some of the political organizations which help to organize the populace for political participation and decision making. Without their presence, the electorates may not be able to make informed choices which could affect their welfare and well-being. Therefore, political parties are central to modern democratic system. Yet, unless they are institutionalized, they might not play roles carved out for them under this system efficiently and effectively. Party is institutionalized when as “...organization, it is detach from being a means to an end to become an end in itself” (Gunther and Hopkin, 2002). A party is institutionalized when it acquires values and stability (ibid). A nebulous party system can not midwife the dividends of democracy nor help resolve the manifold contradictions in a neo-liberal market economy because of lack of doctrinal and programmatic orientation, lack of internal democracy, separation of power, etc.

There is need to evolve a new political culture away from ethno-religious politics, win at all cost syndrome, prebendal use of state positions and intemperate political utterances. These political attitudes and behaviours over-heat the polity and divert political energies into unproductive ventures. Government by politicians should be able to create conditions necessary for democratic consolidation and not breakdown as it was in previous Republics. Brokerage and patronage politics should be deemphasized for politics of tolerance and accommodation, consultation, bargaining and compromise. Internal party democracy should be pursued to give the people a say in how the party is run, respect for institutional rules and the practice of good governance in the running of the party finance, separation of powers within the party organization, among others. It is when these core democratic values are in place, that democracy can take root in the society.

One of the intractable problems Nigerians have had to contend with is electricity (Power) supply. As the government has observed, “the availability of electricity (power) is a sine qua non for economic and industrial development of any nation” (Reform of the Electric Sector, 2005). This is because, “in contemporary times, the per capital consumption of electricity determines the level of

industrial activities and hence the development cum standard of living of any nation” (Ibid). Nigeria with a population of over 150 million people is said to generate below 4000mw with a 0.0BKW per capital consumption. Government had envisaged that by 2007 it would be able to generate 10,000mw of electricity. Yet, reliable power supply is inaccessible to majority of Nigerians talk less of having it at affordable prices (Reform of the Electric Sector, 2005) .

To improve electricity supply, the Jonathan administration has signed a number of contracts to build new power stations and improve electricity distribution to Nigerians. In pursuance of this goal, the Federal Executive Council (FEC) recently approved ₦8bn for the construction of five additional power substations to address the lingering problem in the national power grid (Punch, July, 28, 2012). Following the abysmal power supply in the country, the FEC again, approved the construction of the strategic gas pipeline from Obiaku Obrikon in Rivers State to Oben in Edo State at a cost of over ₦60bn (ibid). It is yet to be seen how these measures would improve the epileptic power supply across the country. A point that need be emphasized is that unless and until there is behavioural and attitudinal changes among stakeholders in the electricity sector, like the oil and gas sector, it will be hard to achieve efficient and effective power supply in the country.

We will like to end this discussion by stating that for the country to break from the tragedy of the past, the respect for the rule of law and constitutionalism hold the key. The law is no respecter of persons therefore; there should be no sacred cows in its application. This is why a people centered constitution should urgently be put in place. The subsisting constitution in the country came to being through military fiat though the then head of the ruling military junta claimed that their usual “wide consultations” were carried out. Yet, the constitution remains an albatross by virtue of its exclusiveness. A political culture should be evolved that will make the spirit of the constitution rather than its letters, the driving force behind state and individual actions in the public and private realms.

As Rousseau has rightly admonished:

.....The real constitution of the state which acquires new strength daily, which when other laws grow old pass away revives then (which) preserved a people in the spirit of their institutions and in perceptibility substitutes the force of habit for that of authority is the constitution graven.....in the hearts of the citizens (See Eckstein, 1963).

It is the spirit in the constitution graven in the heart of its operators and those affected by it that keep society together and make its institutions function. The call for a new constitution should not mean that once given, it would resolve the numerous challenges facing the nation. If when such constitution is put to use that it could moderate the conduct of state duties and its force comes alive. This is what well meaning Nigerians should aim at.

All these efforts could only take place in the context of peace. It is by now a truism that the main goal of every independent state is to provide security for its citizens (Magstadt, 2006). This view is ably supported by Hobbes (in Magstadt, ibid) when he argues that “safety from harm constitutes the chief justification for government’s existence”. The politics of impunity in the country should give way for consensual politics. As some statesmen rightly noted, Nigerians now live in fear due to the security concerns in the country. Those at peace work for it. The surest basis for peace is social security. It is when the people are assured better standard of living that political and social security endures.

Conclusion

Economic prosperity and social security are key ingredients for the substance of democracy anywhere in the world. This is because better economic performance leads to improvement in the people’s standard of living. This explains why we have argued that the present economic condition in the country that has taken the people below poverty line portends danger for the country’s nascent democracy. In Africa in general and Nigeria in particular, politicians tend to capitalize on the

electorates' socio-economic condition to manipulate and influence their choices at the polls. This is done through monetary inducement and or distribution of essential but scarce commodities in this part of the world, such as: rice, sugar, milk and even bread before and during elections. The phenomenon of material shortage has also made it expedient for politicians to seek office because of material gain. In this context, democracy is endangered and the possibility of its consolidation becomes far-fetched.

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MEN AND THEIR PORTRAYAL IN *BELOVED*: THE FRAMING OF BLACK AND WHITE MASCULINITIES IN A SLAVE-OWNING WORLD

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Abstract:

Because Toni Morrison explores the lives of women in all her novels, most critics read her works as mainly woman-centered while most studies of her male characters present the men and their stories as secondary to that of the women characters. However, Morrison also explores the constructions of masculinities as complicated by race and history in her works. Through her male characters' lives in *Beloved*, Morrison demonstrates the complexities and paradoxes inherent in the making of black masculinities and the oppression and denial of selfhood they experience in a slave-owning era. She thus tells the stories of black male characters and invests them with voice and visibility. To clearly bring out the realities of being black, male and subordinated, she contrasts black masculinities with the dominant white hegemonic masculinity practices that restrict and negatively define black men. Using the lives of selected black and white male characters in *Beloved*, this paper examines the manifestations of white hegemonic masculinities in the white characters' lives and their impact on black men. It also analyzes the creation and operations of black or subordinated masculinities within the oppressive and often horrific circumstances in which black men find themselves.

Key Words: Hegemonic masculinities, Subordinated masculinities, Slave narratives, racism

Introduction

Beloved is a twentieth century novel fashioned as a historical slave narrative that is set in the era after the Civil War in Cincinnati. Its story is told from the perspective of former slaves, and the novel depicts their resilience and incredible will to survive in a peculiarly harsh world. *Beloved* also attempts to augment slave narratives in order to fill in the missing pieces of information on slaves' lives. This was because most slave narratives were characterized by self-masking in order to make them acceptable to the white reading public of earlier times. As Morrison states of her work, her task was one of "how to rip the veil drawn over proceedings too terrible to relate and to fill in the blanks that the narratives have left" (Henderson, 63). *Beloved* is based on the true story of Margaret Garner, a slave woman who kills her baby daughter, rather than let her grow up a slave. Even though it seems to be Garner's story, it is also very much the story of male characters such as Paul D, Sixo and Halle. As Morrison points out, "*Beloved* was about those anonymous people called slaves . . ." (Sitter 17). This shows Morrison's concern with both men and women. Additionally, the stories of the women characters in *Beloved* are incomplete without those of the men's. *Beloved* then is not only Morrison's attempt to give Garner a voice but to highlight the circumstances and position of black men and tell their stories from their own perspectives—a viewpoint that has often been denigrated and denied expression in their white and racist world.

Male Portrayals in *Beloved*

Sixo is a pivotal character through whom Morrison portrays an alternative African-based masculinity. Sixo is one of six male slaves on the Sweet Home plantation in Kentucky, and he is described as a confident person. He comes from and has grown up in Africa and so he knows his roots and culture. He is "Indigo with a flame-red tongue" indicating his unmixed African heritage (21). He is gentle and speaks English. He tries to keep alive his African way of life by replicating the cooking methods of his native country. Because of this, he cooks potatoes in a hot pit but they are never well done. The other Sweet Home men laugh at his attempts, but he is undeterred. His

experimentation shows an inquiring and persistent mind that seeks to improve. So determined is he to remember his African life that he decides to disregard American time, and stubbornly sticks to telling time from his own perspective “so he never got it right” (21). In African traditional belief, “time is simply a composition of events that have occurred, those which are taking place now and those which are immediately to occur” writes Mbiti. “The linear concept of time in Western thought, with an indefinite past, present and infinite, is practically foreign to African thinking,” he concludes (17). Because of this concept, Sixo miscalculates his rendezvous time when he goes to meet his lover, Patsy. Yet he walks sixty miles in thirty-four hours, with only an hour of rest, and time enough to say hello to his Thirty- Mile woman. Sixo has the qualities of strength and endurance associated with a warrior, but without the violence that is an integral part of a warrior’s life. His slave circumstances modify his ability to practice a dominant and martial kind of masculinity. Sixo is a loving, patient person who cherishes his lover, and his funny mistakes make him human. Here, Morrison points to an alternative masculinity that is at once both strong and humane.

Morrison’s depiction of Sixo contradicts the prevailing, white beliefs about African men. Commenting on these beliefs, Segal reveals that eighteenth-and nineteenth-century white philosophers and slavers such as William Harris, Thomas Carlyle, and Thomas Huxley, described Africans as “inferior breeds of men” and “absolute savages full of evil passions” (171). Sixo does not conform to these stereotypes in intellect or attitude. He has a deep knowledge of the land and agriculture, and he is very intelligent. When the crops fail on Sweet Home farm, Sixo is the one who realizes that there are pests destroying the vine. It is clear that he is in tune with plant and natural life, and is an intelligent and rational person.

Sixo’s manhood is manifested in his knowledge and farsightedness. He is very observant, so, even though he is not schooled in the Western mode of education, he analyzes situations accurately. He is the one who says that their owner, Garner’s death is a murder. He alone notices the bullet-hole in Garner’s head. Again, he tells the Sweet Home slave men that Mrs Garner is sick because schoolteacher is slowly poisoning her with medicine used for putting down horses. Nothing escapes him. At night, he creeps around and outside the farm, observing the lay of the land. It is not surprising that he is the first Sweet Home slave to learn about the train. He realizes that the most pernicious effect of slavery is the culture of brainwashing. He thus resists any imposition and influences of white culture. He refuses to learn to read and write because he sees that education is not an innocent process, but a means of transmitting cultural values. Because of this, he concludes that Western education will enslave his mind and ruin his culture and he refuses to be schooled. Sixo’s strong belief in the validity of the oral cultural traditions of Africa convinces him that “reading and writing would make him forget things he shouldn’t” (219).

Sixo’s masculinity is also characterized by spirituality and a deep love and respect for nature. Once, before entering the Redmen’s (Native Americans’) structure, he asks permission from them before entering the structure (25). After that, he asks for their presence to be with him. He clearly exhibits the African belief in ancestors—the living –dead of the spiritual world. In his study of the spirits of the living-dead, Mbiti states that Africans are most concerned with the living-dead and believe that “it is through the living-dead that the spirit world becomes personal to men. They are still a part of their human families” (83). Africans also see the living-dead as “the guardians of family affairs, traditions, ethics and activities” (83). Because of this belief, Sixo respects others’ culture—an attitude that is opposite to white, male cultural practices of demeaning, dissecting and desecrating others’ culture and artifacts. Like many Africans, Sixo believes that Nature is a living thing that communicates with humans. Mbiti states that in Africa, “in a few cases, the wind is associated with God. Some people describe him metaphorically as being like the wind or air, or moving like the wind; and others think that the wind is one of the vehicles by which God travels in great power through the sky” (54). Because of his worldview, Sixo asks the wind to help him find Patsy, his lover when she fails to arrive at their meeting place. She has apparently lost her way but the wind helps Sixo find her. Here, Morrison validates the power and reality of alternative African beliefs that seem nonsensical to Western minds. Despite the fact that Sixo wants to spend time with Patsy, he knows that her absence might be detected by her owner so he shows her a shortcut by which to get back quickly to the plantation, thirty miles away. To save her from possible trouble, he punctures her heel to fake a snakebite accident to her master. Sixo is at once a loving and compassionate person and at the same time, he demonstrates masculine skills of strength, endurance and athletic abilities—qualities

associated with warriors in Africa of that period. Sixo's characterization illustrates the complex nature of masculinities by revealing how apparently contradictory qualities can constitute a positive type of masculinity. Morrison draws Sixo on a mythical scale, especially in his warrior-like abilities. Warriors have long been respected and legendary figures in African mythology. They are known for their courage, endurance, stealth, intelligence and encounters with supernatural forces. Sixo has these manly qualities, yet he is also endowed with humane qualities of love and gentleness. Despite his masculine traits, Sixo does not hurt or dominate his friends.

Sixo observes African customs and demonstrates strong powers of storytelling and dancing, traits usually regarded as womanly by white, masculine culture, but which in African cultures are considered as an equally masculine and feminine art form. In Sixo's recounting of a tale, "He told his story in the peculiar way that made them cry-laugh" (25). Sixo brings this expressive and artistic talent from Africa. He draws on the culture of storytelling and performance, replicated night after night, in African villages and towns. Sixo dances naked among the trees at night "to keep his bloodlines open" (25). This is possibly a ritual dance used to re-affirm who he is in a strange land, and help him hold on to the memory of his people and culture. It is clear that Sixo has a strong sense of identity and self because he has grown up in Africa before being forcibly brought to America. His total rejection of white, American, masculinist culture is evident when he refuses to speak English any more. He stops "because there was no future in it" (25). He knows that there is no possibility of acceptance for the black man in white America, no matter how hard he tries to assimilate because the stigma of racism and slavery cannot be taken away. He does not feel the need to conform to a system based on an ethos of violence and domination. He still remembers a different and more humane cultural reality and existence.

Sixo feels no loyalty to any white man. He has escaped the cultural brainwashing of a white, dominant culture and masculinity. He is already assured of his manhood, and he is not dependent on any one to call him a man. Sixo has no fear or respect for Garner, schoolteacher or the slavers. He is a unique individual, and Mrs. Garner knows this. That is why she wants to find out how Schoolteacher is treating him. He is the only Sweet Home man who does not feel sorry that Garner is dead. Later, when Schoolteacher takes over Sweet Home and begins to systematically destroy the slaves' lives, Paul D says of Sixo, "he was mighty sorry" that Garner was dead (219). He understands how slave society is organized, based on racial stereotypes and suspicions of black men. Sixo argues that Mrs Garner calls in Schoolteacher because "she need another white on the place" (220). She is part of the system that mistrusts blacks, no matter how loyal they are. Sixo knows that to whites at this time, a black man is less than human. He is basically a brute who is dangerous to white women. "The notion that Negro men were particularly virile, promiscuous, and lusty was not new in the eighteenth century," writes Winthrop Jordan, "but the English colonists in America showed signs of adding a half-conscious and revealingly specific corollary: They sometimes suggested that Negro men lusted after white women" (151). It is sad that the other Sweet Home men on the plantation are naïve on that score. They think their relationship with Garner protects them from the brutalities of the slave system. This is why when Sixo warns them about Schoolteacher, they dismiss his words as "dark stories" (221). When Schoolteacher begins to teach them things they cannot learn, Sethe, Halle's wife says, "we all laughed about that—except Sixo" (190). Because Sixo is perceptive and mentally outside the slave system, he is aware of its destructive power.

Sixo's forebodings about Schoolteacher are proven true when Schoolteacher criminalizes every action the slave men take, and maltreats them. All the limited freedom Garner gives the Sweet Home men is taken away. Sixo kills a shoat because they are now underfed and he is interrogated like a criminal, but he faces Schoolteacher without fear. His astute mind, and irreverence for the trappings of white masculinity are seen when he replies that his act means, "improving your property" (190). The dialog between Schoolteacher and Sixo shows two sets of values and oppositional ways of seeing. Even though Sixo wins the argument with him, Schoolteacher "beats him anyway to show that definitions belong to the definers—not the defined" (190). This is an act of power to teach Sixo and the other black men their subject position. Connell calls the kind of power wielded by schoolteacher and other whites, 'hegemony'. "Hegemony," he writes, "relates to the cultural dominance in the society as a whole. Within the overall framework there are specific gender relations of dominance and subordination between groups of men" (78). Morrison exposes the extent to which black masculinity is circumscribed by white oppression in this instance. Schoolteacher further

restricts the little freedom Sixo and the others have by taking away their guns, banning them from going off the plantation and treating them like children.

Sixo's desire for freedom is strong and he begins to plan his escape especially when he realizes that Schoolteacher is a cruel master. When he suggests that the other slave men leave Sweet Home too, they ask him to delay his plans. Because of these men's loyalty to Garner, they decide to wait a littler longer before escaping. Meanwhile Sixo prepares for his day of freedom. His knowledge of the lay of the land and stars help him as he observes the North Star that will aid their escape. The North Star is a common image in antislavery culture, and stands as a beacon of hope and a guide to freedom for slaves. Sixo is practical, takes initiative and makes the contact for guides to help in their escape. He also manages to hide the supplies that he knows will be needed for their journey. Amidst this preparation, he neither hesitates nor shows fear even though he is aware of the consequences of being found out.

Unfortunately, because of so many delays, Sixo's escape plan is detected and then he and the other men are punished. Sixo and Paul D are surprised and arrested, but not before Sixo manages to help Sethe's children and Patsy, his woman to escape. Paul A is hanged and Halle goes mad after witnessing Sethe's violation by Schoolteacher's nephews. Sixo is recaptured but he does not go without a fight. Even with his hands tied, he wrestles the gun out of the white men's hands and manages to crack one person's ribs but he is knocked out, and when he comes to, he is tied to a tree. Sixo begins to sing in his language—a song that is described as frightening and powerful, and which also makes his captors uneasy and afraid. Listening to it, Paul D "understood the sound: hatred so loose it was juba" (227). This symbolizes the depth of Sixo's hatred and contempt for the white men, and slavery. Sixo's warrior-like qualities are reshaped to meet a different need. Instead of violence and bloody deeds, Sixo's battle is against fear, yet his mind overcomes the fear of his captors and his impending, horrible death.

Paul D reflects later that even though slave society denies a person power and authority, things that signify manhood in slave society, Sixo's African-inspired masculinity causes him to display resolve, courage and autonomy over his own life. Due to the influence of the alternative norms he lives by, he does not hesitate to employ his intellect and belief systems to aid the slave men's plan for freedom. Because he refuses to be influenced by the prevailing culture, his African based masculinity functions as an oppositional element in the white, slave society. His masculinity practice is modified because of his location within a racist, cultural system and its severe restrictions on his life. So, even though Sixo's masculinity is not defined or animated by the same factors that empower and shape white masculinities, it takes as its source, those African norms that he learned back home, to forge a new and alternative masculinity that is suitable for coping with his situation. This alternative masculinity ensures that Sixo's mind is his own. Through Sixo, Morrison shows how an alternative, yet subordinated manhood can still negotiate within a horrific and restricted system, to forge a brotherhood with other slave men, and to be a source of knowledge and inspiration to them and their families.

Sixo's courage even in the face of death is remarkable and makes us aware that a person can be heroic even in terrible circumstances. After his escape plan is detected, Sixo's song and fearless attitude indicate that he is a man that the slavers can never break so Schoolteacher orders him to be burnt, saying, "This one will never be suitable" (226). As he burns, Sixo begins to laugh "a rippling sound like Sethe's sons make when they tumble in hay or splash in rainwater" (226). His actions are shocking and inexplicable to the white men gathered around because his flesh and clothes are burning and his laughter expresses pure delight. Because of Sixo's cultural beliefs, he knows that death only releases him from an oppressive system, to the world of his ancestors. As an African man and warrior, Sixo would be expected to display endurance and courage in the face of extreme torture and death. This is the ultimate test of African manhood, and his attitude frightens his white captors, "men who were not embarrassed that their manhood lay in their guns... men who made even vixens laugh" (162). Morrison portrays the difference between African-based and white American cultural ideas of masculinities in this incident. To the African mind, white masculinities are worthless and cowardly, because they depend on guns and brute force. Seeing that they cannot stand or stop Sixo's defiant song and laughter, the men shoot him, but not before he shouts his final chant, "Seven O, Seven O" (226). His seed has escaped with his woman, Patsy. The continuation of his lineage is assured and he knows his death is not in vain. Sixo's life and the manner of his death also serve as a source of

inspiration for Paul D as he attempts to forge a more viable manhood for himself. Noting the place of white violence within the system of masculinities, Connell writes: “Many members of the privileged group use violence to sustain their dominance”, he continues, “violence can become a way of claiming or asserting masculinity in group struggles” (83). The violence done to Sixo and the Sweet Home men can then be analyzed as much more than isolated acts of punishment, and be regarded as a contest of masculinities. Because of the gun, the slaves lose out physically, but not mentally, as Morrison shows with Sixo.

Other black men such as Halle are also positively portrayed in *Beloved*. Halle is as astute as Sixo in his analyses of the slave system and slave master. Even when Sethe says that Garner is better than Schoolteacher and other slave masters, Halle replies that there is no difference between them. He is not fooled by Garner’s supposed goodness in letting him buy back his mother. He lets Sethe understand that that arrangement profits only Garner: “I pay him for her last years and in return he got you, me, and three more coming up” (196) he states. Halle is very gentle, hard working, and the most pleasant of the Sweet Home men. He learns to read and write, and his intelligence is proven by the fact that he is Garner’s bookkeeper. He is a loving son who hires out his time and gets deeply in debt to procure his mother’s freedom. He is a strong man who is loyal to the Garners and other Sweet Home men. He is also described as a compassionate man. Denver says of him “my daddy was an angel man. He could tell where you hurt and he could fix it too” (208). He cherishes Sethe and treats her as an equal. He dreams of freedom for his whole family but his plans are thwarted when Schoolteacher forbids him from hiring himself out to buy his family back. Halle does not make it to freedom. After watching Sethe’s violation at the hands of Schoolteacher’s nephews, he goes mad. He is seen at the end with clabber smeared all over his face. However, because of his love for family and friends and his sense of responsibility for them, his life exhibits a positive and nurturing kind of masculinity.

In *Beloved*, Morrison uses two white men to paint a picture of white masculinity and to contrast it with black masculinities. The first white man one meets is Garner. He runs “a special kind of slavery” (140). Baby Suggs observes that he does not “stud” his slaves or rent them out for sexual use as other slavers do (140). Garner’s slaves bear arms, an act that is illegal in Kentucky. They are free to advise or criticize him and choose how to do their chores. However, the perceptive Baby Suggs worries about the lack of female companions for the maturing men. Garner does not really care about that aspect, and the men end up having sex with cows. Despite being outwardly benevolent, Garner toys with the lives of his slaves. He treats them differently in order to live up to his boast that he has the power to make them men. Writing about white masculinity, Connell notes “White men’s masculinities, for instance, are created not only in relation to white women but also to black men” (75). Garner’s ability to control others makes him a man. He boasts to his neighbors about his power to confer manhood on his slaves. This ends up “in a fierce argument, sometimes a fight, and Garner came home bruised and pleased, having demonstrated one more time what a real Kentuckian was: one tough enough and smart enough to make and call his own niggers men” (11).

Garner’s masculinity represents one mold of white masculinities that displays contradictions, which eventually destroys him. On the one hand, he seems compassionate and non-racist, but on the other hand, Garner displays attributes of the dominant masculinity. He is a competitive, rugged, boastful, risk-taking and violent person. He wants his neighbors to acknowledge his superiority in intelligence, physical strength and control of slaves. He is a rebel in the slave society, not because he cares about his slaves, but because he needs to prove his masculinity to all. Eventually, his attitude gets him killed. Looking closely at his acts, one realizes that he forbids his slaves to go anywhere, except in his company, not because of the law but what he sees as “the danger of men-bred slaves on the loose” (141). He is implicated in maintaining a hegemonic masculinity and keeping his men subordinated in the same way as the most debased slavers of his era. Even his agreement to let Halle buy his mother, Baby Suggs’ freedom is not motivated by kindness but by profit, and Baby Suggs and Halle recognize that. Garner is the only one who gains in this transaction. It is not surprising that Halle and Sixo do not see any difference between him and Schoolteacher.

Schoolteacher is outwardly very different from Garner. He lacks the physical presence of the former. Sethe describes him as “a little man. Short. Always wore a collar even in the fields” (36). He “talks soft and spit in handkerchiefs. Gentle in a lot of ways. You know the kind who know Jesus by name . . .” (37). The men realize that he is physically weak but cunning. Schoolteacher’s

appearance and actions are contrary to the masculine norms of the day, yet he wreaks the greatest destruction on the Sweet Home men. Morrison uses him to portray the most dangerous and insidious aspects of slavery. Schoolteacher is obviously well educated, a Christian and pseudo-scientist who has imbibed the 'learned' discourse on Africans and Negroes and does 'research' on the slaves at the plantation. He quickly takes away whatever rights the men have and claims that there is no way a slave can be a man. He starves the Sweet Home men and beats them to show his power. His masculinity is representative of another mold, which is different from Garner's. Schoolteacher's masculinity is based more on intellectual pursuits and psychological manipulation. Even though he lacks the physical prowess to do 'manly' things, he is cunning enough to manipulate others to do his dirty work. His nephews and other white men kill and violate the slaves on his orders. His acts achieve more horrific results than those of the slave owners who control their slaves through the use of force. Morrison portrays Schoolteacher in such a negative light because she is aware that men such as Schoolteacher are responsible for formulating subtle and lying 'facts' that have created racist theories and led to the brutalization and exploitation of millions of black people.

Schoolteacher debases Sethe by studying her 'animal' characteristics. Here, he is cast in the mold of Charles White, who in the eighteenth century, claimed to have studied the Negro as a species and "found him to be an inferior species of man who closely resembled the ape in many ways" (Jordan 501). Jordan also quotes Cotton Mather, the American religious reformer, as writing about blacks thus: "Indeed their stupidity is a discouragement" (187). Schoolteacher's catalog of "characteristics" that purportedly describes the animalistic traits of black people was actually based on a list of black characteristics documented by a slave owner--Arthur Lee. Lee claimed that "African characteristics were cruelty, cunning, perfidy and cowardice. Their feeding habits were like those of absolute brutes" (309). Lee also declared that Africans' understanding was shallow and their hearts vindictive and base (309). These theories were dangerous and still have destructive power in today's world.

The formulation of these theories were not accidental or innocent acts; they were important to the construction of white masculinity. While the white man represented the mind, in the eyes of white writers, the black man represented the body. The white man was rational, courageous, knowledgeable and powerful, whereas the black man was irrational, cowardly, ignorant and destined to serve the white races. Segal writes that the white public in Europe and America of the 1800's were acquainted with racist views that claimed that black men were infantile and mentally inept (169). Segal also exposes the literature of devaluation produced in the eighteenth century which described blacks as "beastly, lascivious, ugly and violent" and presented slavery as beneficial for the "poor wretches" (169). The black man was used "as the necessary foil, the essential opposition, giving substance to the superiority of the white man", Segal concludes (172). Jonathan Rutherford notes that "the history of imperialism and the colonial experience has produced a meaning of blackness, of an Other that constructs a sense of white supremacy and coherence in relation to this alien threat" (60). Schoolteacher and other white men's fear of having a black man around white women was because they saw him as a hypersexed being who desired white women. Jordan quotes other writers of that period who claim that "the penis of an African is larger than that of an European" (501), an indication that he was lascivious. Analyzing this fear of black men, Jordan states "it is apparent that white men projected their own desires onto Negroes" (151). Segal also writes about the hypersexed image that white males have traditionally given to the black man. She quotes James Baldwin as saying "the white man's private fears and longings are projected onto the Negro" (176). Rutherford also argues that the black man "becomes the constructed image of the white man's repressed lust; imbued with an animal-like sexuality and a huge penis, a body closer to nature than the 'cultured' white man. These are images of what the white man denies in himself" (63). Commenting on the damage this theory has created, Baldwin says "If you want to know about the unhealthy psyche of a white man, ask a black man" (qtd. in Segal, 176).

Another terrible fallout of these oppositional masculinity practices has been the lynching of hundreds of black people, and the myth of the black rapist. Segal and Jordan state that the reality has been the rape of thousands of black women by white men, which has led to the creation of mixed-race people in America. Through Schoolteacher, Morrison effectively brings up these issues, and shows how intricately racism and slavery are bound up with white masculinities. She also exposes the subtleties that mask virulent forms of racism and masculinity behind a benevolent or rational mask.

Analyzing the conditions black men experience, Connell writes, “Hegemonic masculinity among whites sustains the institutional oppression and physical terror that have framed the making of masculinities in black communities” (80). Despite these harsh realities, the male characters in *Beloved* are not deterred in their quest for identity and wholeness.

Conclusion

It is clear that black masculine ideals are equated with the attainment of personal freedom and a measure of autonomy for the black male characters. None of the black males analyzed in this article achieve these goals fully but they still manage to create an alternative masculinity that refuses to follow a pattern of domination and violence such as characterizes hegemonic, white masculinity. Thus, Morrison’s portrayal of Sixo validates an African-based brand of masculinity that is not patriarchal in nature and is characterized by compassion, love and respect for women, other cultures and nature. Through Halle also, Morrison shows the nurturing, sacrificial, loving and intelligent aspects of alternative black masculinities. Finally, through her positive depictions of these black male characters, Morrison proves that she does not only portray one-sided and often pathological male characters as Holloway and Demetrakopoulous (86) note, but she also validates and centers positive male characters in her works.

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JEWISH ISSUE IN FRIEDRICH GORENSTEIN'S WRITING

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Abstract:

The paper discusses the specific features in the depiction of the Jewish issue in the writings by Friedrich Gorenstein. The nationality of Gorenstein is not hard to define, while his writing is much more ambiguous to classify in any national tradition. The Jewish theme is undoubtedly the leading one in his writing. Jewish issue is a part of discussions about private fates, the history of Russia, the Biblical sense of the existence of the whole humankind. Jewish subject matter as such appears in all of his works and these are different parts of a single system. Certainly, Jewish issues partially differ in various literary works by Gorenstein but implicitly they are present in all texts and it is not his own intentional wish to emphasize the Jewish issue: Jewish world is a part of the universe, it is not just the tragic fate of a people but a test of humankind for humanism, for the possibility to become worthy of the supreme redemption. The Jewish world of Gorenstein is a mosaic world in essence. The sign of exile and dispersal is never lifted.

Key Words: Jewish, Biblical, anti-Semitism

Introduction

The phenomenon of the reception of one culture in the framework of other cultures has been known since the antiquity. Since the ancient times, intercultural dialogue has been implemented exactly in this form. And this reception of another culture does not claim to be objective. On the contrary, it reflects not the peculiarities of the culture perceived, but rather the particularities of artistic consciousness of the perceiving culture.

In this context, the reception of the Jewish world or "the Jewish text" in other cultures is important. With regard to Jews, the traditional (in this respect) opposition "one's own – alien" is activated, which most universally demonstrates the attitude to other peoples in the framework of one particular culture (Belova, Petruhin 2007). Since the 20th century, the Jewish issue appears to be in the centre of attention of Jewish literature itself, which exists in two languages (Yiddish and Hebrew), and of such a specific phenomenon as Russian-Jewish literature (Markish 1997; 185). It is this Russian-Jewish literature that attempts to define the place of Jews in the environment of other cultures. But, taking into account the specific features of the Jewish community in Russia, the opposition "one's own – alien" is correlated: Jews are a part of Russian and Soviet history; the majority of Jews prefer assimilation or choose the Russian language as the basic language of communication. Finally, the particular perception of the Jewish issue is related to the specifics of the Holocaust in the territory of the Soviet Union. In this respect, the creative works by F. Gorenstein is a representation of an original model.

Main Text

Friedrich Gorenstein's writing stands out in the twentieth-century literature as a most distinct phenomenon. However, despite its significance, it has not been thoroughly studied as yet. Mina Polanskaya borrowed for the title of first Gorenstein's biography the writer's expression about himself: "I am an illegal writer" (Polynskaja 2003). This phrase has greatly determined the attitude towards Gorenstein that had long been characteristic of Russian literary circles. Gorenstein was a person of utterly original views about history and fate of humankind. His own fate was also unique and full of dramatic occasions interacting with all the major events of the twentieth-century history: in 1935 his father was arrested and executed, during the evacuation in the years of World War II his mother died and Gorenstein spent some years in children's home, later he worked as an engineer in a

mine, experienced disillusionment about the renewal of the period of Thaw, he as a writer was banned from publication in the Soviet Union, in 1980 he emigrated to Germany, lived up to the return of his literary works to Russia but faced misunderstanding and rejection of his writing by many literary critics. Most obviously, the nationality of Gorenstein also played a certain role in his biography and creative life.

The nationality of Gorenstein is not hard to define, while his writing is much more ambiguous to classify in any national tradition. Following the existing elaborated model, his works may be related to the tradition of Russian-Jewish literature. However, Gorenstein himself was rather critical about the fact of the very existence of such a definition: "First of all, as concerns Russian-Jewish literature. There has never existed such literature and it can never exist. I have written with great precision about this in my pamphlet. It is possible to talk about either Jewish or Russian literature. Belonging to either of these traditions is defined by the language the writer uses and not by his own nationality. Otherwise Joseph Conrad would have been not an English but a Polish-English writer. There are numerous other examples of this kind" (Polynskaja 2011; 144).

Nevertheless, the Jewish theme is undoubtedly the leading one in his writing. Jewish issue is a part of discussions about private fates, the history of Russia, the Biblical sense of the existence of the whole humankind. Jewish subject matter as such appears in all of his works and these are different parts of a single system. Certainly, Jewish issues partially differ in various literary works by Gorenstein but implicitly they are present in all texts and it is not his own intentional wish to emphasize the Jewish issue: Jewish world is a part of the universe, it is not just the tragic fate of a people but a test of humankind for humanism, for the possibility to become worthy of the supreme redemption.

The novel "Letit sebe aeroplan" (The Aeroplane Keeps Flying) is concerned with the fate of the outstanding artist Marc Chagall. In the novel "Iskupleniye" (Redemption) Jewish issues are regarded in a rather fragmented manner but in relation to the theme that is very significant for the writer – that of exterminating Jews in the years of World War II. In Gorenstein's texts the word 'Holocaust' is never mentioned. Yet all his writing strives towards the embodiment of the grandiose idea (unfortunately it was never completed) – creating the documentary "Mesto svalki – Babiy Yar" (The Dumping Place of Babiy Yar"). Gorenstein was actively involved in collecting materials; he planned to put the major emphasis not on the fates of victims but on the search for the murderers and their moral heirs. In another work – the story "Poputchiki" (Fellow-Travelers) the plot line that is more developed depicts the fates of Jews in Ukraine. The story was not published in Russia for a long time because of the author's focus on the historically rooted anti-Semitism in Ukraine. In the whole creative work of Gorenstein, three historical personalities stand out who proposed the ideas of the extermination of Jews: Hitler, Stalin, and Bogdan Hmel'nitski.

In 1975 Gorenstein created two texts that were seemingly very different: the novel "Psalom" (Psalm) and a drama in three acts and eight scenes, 92 scandals, "Berdichev". With all their unlikeness, nevertheless both of these texts are organically related in the framework of different genre structures (novel and drama), built on different material, yet they demonstrate a unified conception of the author about the fates of Jews, fates of Jews in Russia and, consequently, about Russia in general. The vast epic spaciousness of Russia in "Psalom" is replaced by the closed world of the apartment of systems Lutski in "Berdichev"; mythological Dan-Antichrist giving the bitter enlightenment to everybody he meets is replaced by the scandalous Rachel Kapsan nee Lutski. The drama in many senses does not correspond to the claimed genre. "Berdichev", like "Psalom" is closer to an epic narrative.

The novel "Psalom" aroused an upheaval of emotions both in readership and literary scholarship. However, this does not mean that the novel was accepted unconditionally. The specific reflection of the Jewish issue in Russia called forth an ambiguous response that testified to the fact that the novel did not concern the events of the 1970s; it rather concerns eternal problems.

The novel represents a complex interlace of the Biblical and mundane lines united by the common mythological image of Dan-Antichrist. This is a novel about the fate of Russia that is condemned to bear the curse of anti-Semitism. In this world there is a clear division between those persecuted and persecutors. Jewish people have become the persecuted. In everyday life this is manifested in the idea of hostility towards Jews by numerous nations inhabiting Russia (also Soviet Russia). The Biblical context is related to the theme of exile. The fate of the persecuted people of

Israel is in the focus of Gorenstein's attention. Dan Antichrist has come to the earth to defend the persecuted bearing the truth for the persecuted and condemnation for persecutors. Nevertheless the author is distant from the idealization of Jews as a people. In this respect, Gorenstein demonstrates a rather widespread opinion that Jewish people themselves are responsible for being the people of exiles.

The fact of locating Jews in the space of the Soviet Union is essential in the novel. The Soviet Union in the artistic model by Gorenstein is a universal model of space, similar to Babylon, that is a space where the Babylon tower is being erected. The state of Jews in this space is similar to that of Babylonian capture – beginning of life in dispersal, in Diaspora. This is an alien space from the start. In this space one (Jew) is always reminded of being alien. Besides Jews are demanded to become aware of the exceptionality of being allowed to live in the space that has become a certain affinity of the ideological paradise on the earth.

Specific peculiarity of Russian anti-Semitism lies in the fact that it is officially sanctioned by the state (Kostirchenko 2011; 15). Anti-Semitism coming from seemingly individual people is actually a state-inspired doctrine with a legal status. Poet Somov is sure of his joining the Institute of Literature because those are mostly Jews who wish to join it but Russians who have a reference are always welcome there. In some episodes of the novel the guards of the order slightly rebuke the transgressing anti-Semites because they are brethren Slavs, and if they are also former front-line soldiers like Pavlov, no one is ever going to punish them. A whole range of anti-Semitic characters become heralds of the official standpoint (stakhanovets, old woman Veselova). Anti-Semitism is coming from the bottom, it is supported from above and enters the minds of people, even Jews themselves arousing in them hatred towards their own nation. The brightest example to this is the Ivolgin-Kats family that from generation to generation demonstrates striving to dissociate from being Jewish. But the wish not to be a Jew is a wish of individual persons that is not taken into consideration and is suppressed by state ideology. Alexei Ivolgin is reminded by the state of his being Jewish in the form of arrest and absurd murder during interrogation. It must be added that the fate of Ivolgin is just a private episode in a large case of national importance – the case of doctors and that of disclosure of Jewish anti-soviet activities.

From Gorenstein's point of view, Russian consciousness is dominated first and foremost by the idea of collectivity: "Russian forest-steppe character since times immemorial has developed in a collective and up to this day has remained such. This is the reason why individualism is so weak in it, why this character is atheistic, collective, and Russian church even by its external look proves this." (Gorenstein 2001:377) Human turns out to be subject to the opinion of the majority and with this majority is ready to give up spiritual values, everything native and close. Heroes of all tales bear evidence by their fates to the pressure of the collective opinion: they gather in public places (tea-house, bazaar, fair, tenant apartment-house, meeting), they are ready to sacrifice their relatives. Children are easily given over to children's homes or left in the street for someone to collect them, someone to help. The pressure of the collective is capable to cause fear (Ivolgin starts fearing arrest long before a case is actually drawn against him). Anti-Semitism is a manifestation of the totalitarian, the collective. Jews become the necessary sought for victims – the guilty ones who are constantly chased using their success to motivate others' failures and defeats: in the tea-house of the kolkhoz "Krasny pakhar" (Red Ploughman) it is very convenient to see a saboteur in Jewish adolescent Dan, Sulamith is hated for her looking for something on the ground and often finding, the majority of inhabitants in the town of Bor hate Dan and his foster-daughter Rufina because they are Jews and have much money, Claudia constantly reproaches Ivolgin for his Jewish descent, Vasya Korobkov becomes anti-Semitic because many people take him for a Jew by his appearance. Anti-Semitism in Russia becomes a kind of national mass idea that has been cultivated in various historical epochs, on the basis whereof rich folklore with tales, songs, beliefs was formed. Jew was massively treated as alien, yet this alien is just necessary because only through this figure one's power and might could be demonstrated. Anti-Semitism turned out to be a universal phenomenon encompassing all layers of society: peasants and workers, adults and children. Hatred to Jews became a consolidating force that facilitates the sense of unity of the nation.

The issue of interaction and opposition of Christianity and Judaism is one of those paid special attention to by the author. Gorenstein did not consider himself to be a religious person but, according to Mina Polyanskaya, he was a believing person. In his philosophical searchings there was

an attempt at reaching religious synthesis. In one of his letters he wrote as follows: “As concerns culture, I belong to Judaic-Christian culture, Biblical culture including evangelical. Yes, there is no such religion but there is such a culture. The issue of the relationship of Judaism and Christianity is complicated and I cannot give a simplified account of it in a letter” (Polynskaja 2011; 144). In the novel “Psalom”, the theme of relation of Christianity and Judaism appears regarding the theme significant for the whole of Gorenstein’s writing – that of relations between generations, of children: “When an orphan child – Christianity – has lost its Jewish mother because of the eternal rivalry between those who are erecting the Temple and those who are erecting the Babylonian tower, he first came into the hands of those who knew about his mother everything or much but were hostile to that” (Gorenstein 2001: 327). The relations between generations are defined as follows: Christianity is an infant and Judaism – its mother. They are in blood relation where the parental function, the function of the senior and origin is the determining one. The image of Christianity as an infant registers a conceiving, disciple stage. In the couple of infant and parent there is neither the right nor the one to blame, the essence of their break-away from external intrusion lies in the fact that the world as such has lost its unity and has split into two camps. It is true that this opposition already betrays the value position of the author: the Temple is the symbol of spirituality, striving for the eternal and divine, while Babylonian Tower is a symbols of disparity, transience. The image of infant Christianity is endowed with additional symbolism ascending to the image of Jesus Christ, his birth, his cradle – the crib has become a point of departure for the development of Christianity as religion. Similar symbolism makes it possible for Gorenstein to perceive Christianity as religion in its initial stage of infancy. Jesus in the very first pages of the novel is called “Infant, Child, Son”. In Gorenstein’s conception, the bond between parents and children is a sign of eternity. The whole Biblical world is saturated by the idea of continuous bond of generations.

Drama “Berdichev” is far from Biblical problems. Yet exactly this drama is in the context of Gorenstein’s oeuvre a specific version of family saga. On the list of dramatis personae of the drama there are 32 characters, besides even more appear in the course of the action. However, the basic line of action is related to the world of sisters Lutski and people surrounding them (they represent the model of Berdichev world and through it the model of the Jewish world of Russia). Rachel is in the focus of action. Her central role is emphasized also on the list of dramatis personae that she opens. All other characters appear in relation to her: her daughters, grandchildren, nephew, elder sister. She, though being far from Biblical Rachel, is the foremother of the family.

Being the core of the family, Rachel is first of all concerned with the welfare of her family. Her image is closely bound with the opposition of *one’s own/alien*. Despite her pride in being a communist, Rachel does not excel with a sense of collectivism. The joy and sorrow are personal (she can joke about other people’s sorrows). Rachel’s partiality bears an explicit feature of Jewish identity: outcasts as aliens constantly recur in her speech. Within the opposition of *one’s own/alien*, the variation *Jewish/Gentile* occupies the central place. Both worlds do not clash on the basis of conflict, pogroms happen only in memories. Nevertheless the isolation of Jews is given special emphasis. In the perception of Gentiles, Jews are considered to be yids. Outside their home (outside the apartment of Lutski), Jews are in the situation of outcasts (the case near the brethren grave when Mamatyuk pronounces the phrase that outraged Rachel: “Here lie buried all nations that defended their homeland. All nations apart from yids”.) In this respect the majority of characters in the drama choose for themselves to leave the world of Jews (i.e. the world of Berdichev). A situation of a reversed myth ensues.

Two characters of the drama commit exit to Moscow from the world of Berdichev: Vilya and Bronfenmakher. Their exit demonstrated two poles in the evaluation of Berdychev world. Bronfenmakher, relating his fate with Moscow Jews Ovechkis, gives up the Jewish world. Vilya, on the contrary, starts realizing the essence of Berdychev world from distance and, like Rachel (“We are so much like each other with Vilya, aren’t we?”), predicts its future. In his childhood Vilya proved to neighbours that he was a “хуский еврей / russian jew” (“I do not resemble a Jew, do I?”), whereas having grown up he comes to the conclusion: “You may renounce your ideological presumptions but you may not renounce your own nose” (Gorenstein 1991; 389).

The world of Jews and that of Berdichev is the world devoid of any interior bonds. The house of sisters Lutski is the model of this world that has lost the authentic Biblical basis but has not lost its Jewish identity. The apartment of the sisters is a mini-model of Berdichev, a specific model of the Old

Testament space through which the flow of time runs. The apartment remains an island that has sustained the signs of the old Berdichev world. This is ascertained by the relations of people to this apartment. "Freeing" the apartment means freeing it from alien people who do not belong there. Only Rachel and Zlota are its constant abiders. All others come to it temporarily, as visitors to a museum: to look at Vilya who has come from Moscow (also temporarily); these are Bylya (pretending to come for fitting a dress), Makzanik, Ovechkis, Ruzya, and Milya. All of them leave the apartment as aliens. Only the two sisters are its eternal abiders, that is proved by the closing remark: "The big room is dark and empty. The light falls only from the kitchen where the sisters' voices are heard" (Gorenstein 1991; 401).

In the story "Poputchiki", the author again takes up the world of Berdichev and associates this town with the universal model of the Jewish world: "Berdichev is a ghastly town, a town dispersed all over the country, the world, a town inhabited by people who have never stepped upon its streets: a professor from Moscow, a lawyer from New York, an artist from Paris <...> Berdichev is not a usual geographical name but the name of a living being calling forth hatred, derision, fear, shame." (Gorenstein 2011; 345)

Conclusion

The Jewish world of Gorenstein is a mosaic world in essence. The sign of exile and dispersal is never lifted. In the finale of the novel "Psalom" there is a call for return addressed to everyone. These are the words by the prophet Isaiah: „You who remind the Lord, take no rest for yourselves script writer“ (Is. 62:5). For Gorenstein, this is just the supreme sense of life – the calling of creation. But for an artist the fate of an individual human is more interesting than that of a nation. This position is very clearly demonstrated by the hero of the story "Poputchiki": "Human personality is a mystery. It yields only to artistic study, while national and people may be scientifically analyzed and there is nothing mysterious about them" (Gorenstein 2011; 333).

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AN AGENT-BASED-MODELING FOR ELECTORAL PREFERENCE BEHAVIOR: PRESIDENTIAL ELECTIONS OF THE DOMINICAN REPUBLIC 2012

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Abstract:

An agent based model was constructed under the assumption that political preferences of individuals change over the campaign because of social interaction and the influence of global information. During the voting decision process take place a phenomenon known as social contagion, aside from institutional factors and personal preferences. Therefore, voters' change of mind may arise and voter's decision analysis might be influenced by polls or commercial campaign.

Key Words: Agent-Based-Modeling, Human-Computer-Interaction, Artificial Intelligence, Digital Simulation

Introduction

An agent-based model is a type of computer model that allows simulation of actions and interactions of autonomous individuals in an environment, in order to determine their effects over whole system. The models simulate the simultaneous operations of multiple entities (agents), in an attempt to re-create and predict the actions of complex phenomena [3].

This computational model provides a mechanism of social contagion in which each agent is subject to the influence of local and global information. The model also allows combining different institutional elements of the electoral process, as debates, campaigns and negative bias induced by TV or other mass media.

The agent model is structured as a cellular automaton in which a two-dimensional lattice characterizes the geographical space of interaction. The transition rule of each agent (or cell) causes the state variable (intention to vote) varies essentially according to local majority opinions (neighbors preference contagion) and global (media influence or propaganda).

Details of Model

The model described in this paper emphasizes the social contagion among likely voters. It is structured from a cellular automaton where a two-dimensional grid characterizes the geographic space of interaction. The transition rule for each agent makes the state variable (voting intention) varies essentially based on majority views of the population: *For or against the majority, influenced by the media or influenced by the polls.*

An artificial environment is generated and populated with agents representing *Humans Voters* with different electoral preference (Figure 1). The landscape is an n -dimensional cellular automata grid with dimension equivalent to 150x150 square patches and connected circularly. The resulting topology is a torus. The model in question is designed for two parties, based on the average forecast model for the presidential election of the Dominican Republic in 2012, using data from 14 independent surveys from up to 100 days priors to the elections day. The space of social interaction is represented by a grid with 22,500 interactive cells, with borders and Moore neighborhoods type (i.e., each agent has eight neighbors with which it can interact).

Therefore, in this artificial electoral system, the number of potential voters is approximately 22,000 individuals located in a geographical and social context. This simulation can be regarded as corresponding to an average county of the Dominican Republic. Since the electoral system has approximately the same number of registered voters on an average county.

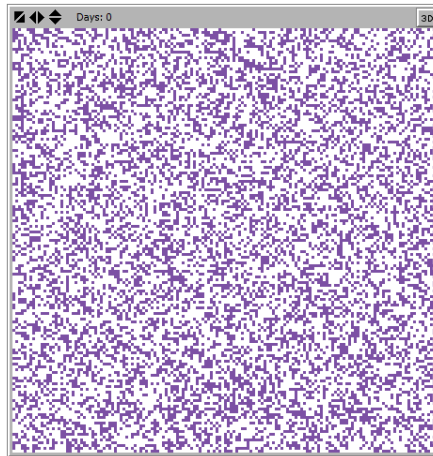


Figure 1: Artificially generated environment.

White dots represent followers of Revolution Party. Purple dots represent followers of the Liberation party

Each Voter Agent has a set of attributes that must be set up before running the simulation. Each voter can have a different set of parameters. These values are generated randomly during the instantiation of each agent. These attributes includes:

Attribute	Description
Party-Vote	Determines the electoral preference of the agent. 0 prefers Revolution Party (X) 1 prefers Party (Y)
iReadNews	Determines if the agent consumes media publicity such as TV campaign, Radio, Internet, etc. If it does, the agent is sensible to media campaigns.
Ideology Threshold (Tolerance)	Determines how malleable the agent is. In electoral terms two states are known as hard-voters and swinger-voters. Hard voters almost never change their preferences. This attribute is set by the calculation of discrete variable finite case [1].

$$Tolerance = (x_1p_1 + x_2p_2 + \dots + x_n p_n) \div (p_1 + p_2 + \dots + p_n)$$

At the beginning of the simulation the electoral scenario can be populated in accordance to a desired composition or distribution of the electoral forces. The initial political preferences of citizens and most of the parameters of the model are calibrated with data from aggregated polls and a database module that tracks the political preferences of the respondents.

For the purpose of our simulation we are using the latest results from a local poll. That places the Revolution Party with a preference of 47% over the Liberation Party with 39%. However the user is free to play with distinct scenarios. The creation of agents is done randomly with a uniform distribution $U [0, USER SET VALUE]$. Attributes are loaded randomly respecting the proportions when they are known. For example, hard voters do not exceed the 30% of the total population for each party [2].

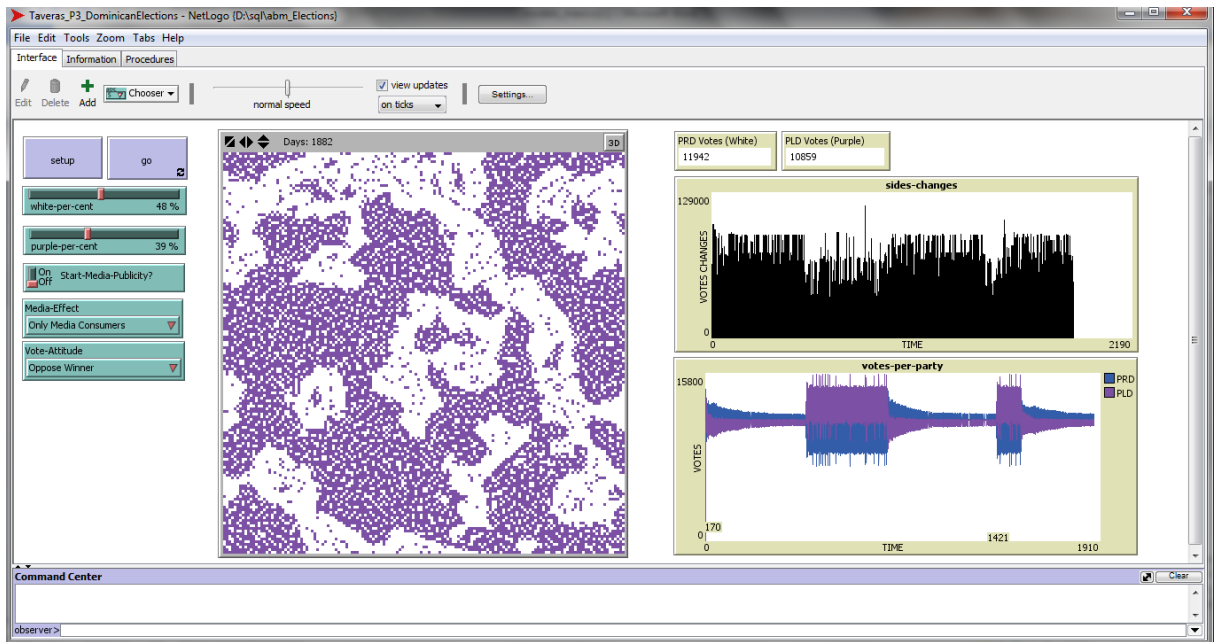


Figure 2: Simulation Environment
Agent-based model, providing a range of results produced during a simulation.

Agent Rules

As mentioned before, initial political preferences of agents and most of the parameters of the model are calibrated with aggregated data from electoral polls and configurable data in the control panel model.

While the party preferences of agents are planted randomly, the values of other variables are set at the beginning of each run based on the following model criteria:

$$A_s = \left(\sum_{k=0}^n (x_k \div (\text{Max Range} \times n)) \frac{1}{n} \right) + \text{Tolerance}$$

(Range: 0-100)

These variables include: ideological commitment (hard-vote and swing-vote), exposure to media, tendency to be influenced by propaganda and socio-demographic attributes (gender, age, education, income and religion). The local information is the sole *source of infection* in the model. This contagion is possible when an agent has been activated in the simulation and communicates with one of its political surrounding partners. The partners are part of the political discussion network that belongs to the vicinity of the agent above a threshold of similarity (i.e., Share at least a number of similar attributes with respect to their political preference). The influence is only viable to the extent that the active agent is not a hard-voter.

In our model, each agent interacts with the neighborhood based upon:

A_s	: Agent political preference
C_s	: Media influence wave
T_A	: Agent threshold tolerance

Specific rules exist during the simulation:

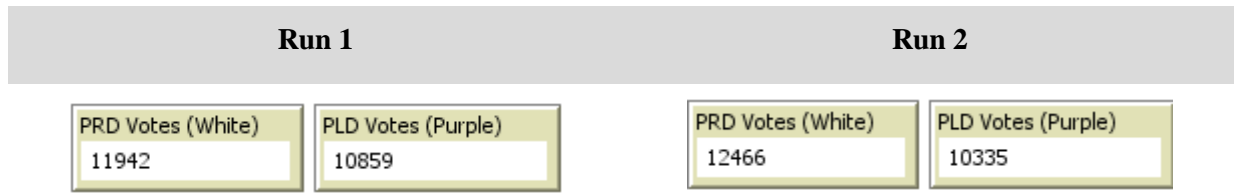
1. Voters agents are placed randomly around the world. During the run of the model voters move one step at a time, selecting a random

direction from 0 – to 320 degrees. They check their position looking for a collision (neighborhood sight) with other agents (voters). Once it occurs, the human agent check for the following rules:

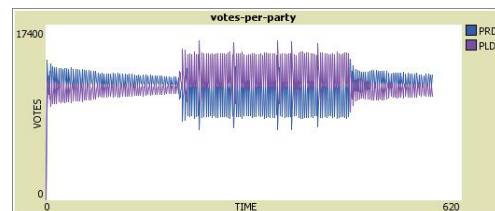
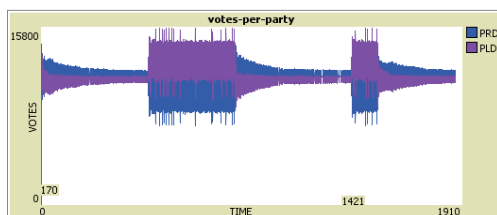
$$A_S \geq (C_S - T_A) \text{ AND } A_S \leq (C_S + T_A)$$

2. Local information is the only source of infection in the model. This contagion is possible when an agent, who has been activated in the simulation, communicates with one of its political partners (neighbors). The partners are part of the network of political discussion if they belong to the neighborhood of the agent and exceed a threshold of similarity. Once the communication occurs, the randomly chosen agent influences the opinion of the neighbor but only when the active agent matches the intension of the majority of the neighborhood.
3. Hard voters' agents only changes if 90% or more of surroundings voters are different and the propaganda is active [4].
4. Weak voters' agents change if more than 50% of the surroundings voters are different independently from the active propaganda [4].
5. If the political campaign activates commercial propaganda, all population is subject to re-think their preferences. With a higher effect on those whose 25% of the surrounding voters are contrary.
6. The simulation could be set to isolate the effect of propaganda only to those agents that are marked as "media consumers".
7. A general behavior can be also activated to simulate the swinging vote of those who "goes with the flow" or when the surroundings of the agents return an even distribution of forces (50%-50%, tie). This means that a setting can be used to determine how some part the population reacts to the actual situation: supporting the expected winner or going against the winner [6].

Conclusions and Future Studies



Distribution of Electoral Forces Over Time



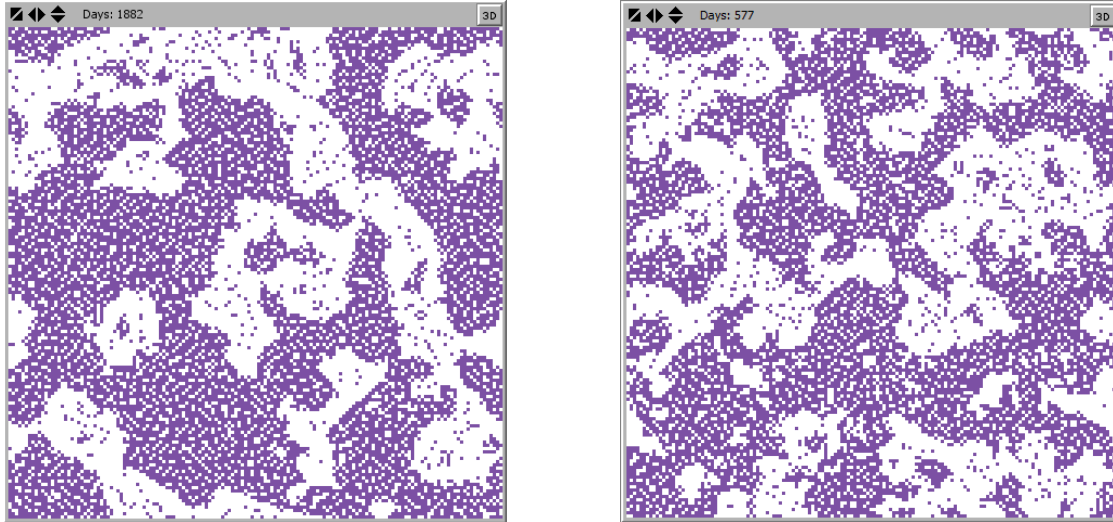


Figure 3: Results from various simulations executions

Figure 3 shows the results of two executions of the model. Each run was executed for 780 ticks, simulating an amount of week's equivalent to 90 calendar days. The agent simulation shows two major trends on the actual behavior of the Dominican Republic electoral population:

1. The simulation confirms that the political distribution of the electoral force on the Dominican Republic is polarized. In any given run, any of the winning parties never gets more than 54% of the total voters. Our conclusion is that this phenomenon responds in part to the 30% of hard votes that is a known constant in the Dominican scenario and the 14% of fluctuating voters who are very sensible to media and the influence of other agents.
2. The simulation confirms that the population is very sensible to the media campaign. It is evident in the resulting graphics that, whenever the Media Campaign is activated, the composition of the chart reflects a mirror effect (Figure 3, Run 1).
3. All the time there is people changing their minds, and these voters are recycled over and over from one party to another. From this can be concluded that the timing on the election and the selection of critical dates for campaign or compromising people, is a critical factor that requires attention when designing the electoral strategy. 9%-15% of the voters doesn't stay for too long on one side, and are always willing to listen for new offers (Figure 3, Run 2).

Behavior of Population Changing Votes Intention

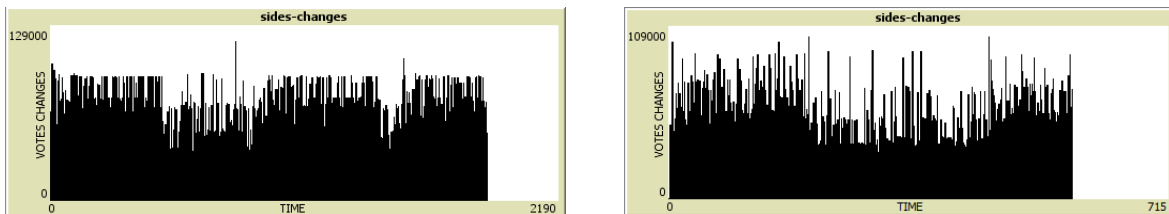


Figure 4: Behavior of Population Changing Party Sides

Future Work

The model could be optimized by including a set of agents that are indifferent to the elections and therefore does not participate in the process. These are called “abstaining voters”. The actual simulation does not consider such type of population. Another element that will be developed for future analysis is the inclusion of socio economic attributes to each agent and the some sort of

communication behavior for a special type of agent known as “activist” or local leader, which can work directly with agents around its area to neutralize the effect of massive propaganda.

The actual system manage approximately 11 million records that could be cross referenced with various databases to produce what is called “electoral characterization”, which in orders words means, defining specific profiles for potential voters in order to develop a “custom campaign” for each person or group. We are also implementing data mining techniques combined with social network analysis and recommendation algorithms.

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PERCEPTIONS ABOUT THE ROLE OF RELIGION IN ENSURING PEACE IN GHANA'S BODY POLITY: A CASE STUDY OF GHANA'S POLITICAL PARTY FUNCTIONARIES

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Abstract:

After experiencing massive social, political and economic upheavals in Ghana between 1966 and 1992, Ghana ushered in constitutional democracy in 1992. Since that period, the country, compared with her neighbours, has been enjoying relative political stability. Prior to adopting the Western type of democracy, after gaining independence in 1957, religion played a significant role in ensuring peace and stability of the body polity. The question that this paper sought to find an answer to is: Do modern-day Ghanaian politicians exercise their political authority based on their religious beliefs and practices like in the past, thereby ensuring peace? Using the country's functionaries of political parties as a case study, the paper sought to answer the question above. Data for the study were collected using both survey questionnaire and in-depth interview from 44 functionaries of political parties through purposive sampling. Both qualitative and quantitative methods were used. Findings from the study were analysed using the Statistical Product for Social Services (SPSS). The positions of Habermas, Rawls and their critics regarding the role of religion in the public sphere formed the theoretical framework for the study. It is the thinking of this paper that, like in the past, opinion leaders, including politicians, should exercise their authority based on their religious convictions, since this would contribute to peace and development.

Key Words: Religion, Politics, Peace, functionaries, political parties

Introduction

Religion is arguably one of the single most significant causes of warfare and turmoil in human history (Abu-Nimer 2001, p. 685; Gopin 1997, p. 1; Diez de Velasco 2007). So much malevolence has been done in the name of religion (Ayer 1976, p. 225 cited in Collins et al. 2006). Religious hierarchies have sided on occasions with the oppressors rather than the oppressed. Alongside the advent of new threats, such as ecological and nuclear disaster, people around the world violate the most basic tenets of their own creeds in promoting state and group terror. Sadly, this impacts mostly on the helpless (Alibhai-Brown 2004, p. 34 cited in Collins et al.). However, so much good has also been done in the name of religion (Ayer 1976 cited in Collins et al. 2006). Examples include the work of the church-sponsored 'Project for the Recovery of Historical Memory' in Guatemala; the mediation efforts by the Catholic Church in Chile; the organisation of reconciliation projects by the churches in Burundi and Rwanda; the activities of the *Comunita di Sant'Egidio* in countries such as Algeria, Guatemala, Kosovo and Uganda; the mediation work of religious communities in Mozambique; church support for and cooperation with the Truth and Reconciliation Commission in South Africa; and the efforts of the Catholic and Protestant churches to promote healing in Northern Ireland (Clark 2010). Religion can, therefore, be described as a force for peace, too. It offers a deep source of understanding, reconciliation, human fellowship and peace that

transcends secular divisions (Abu-Nimer 2001, p. 685; Gopin 1997, p. 1; Rouner 2012; Ramsbotham, Woodhouse and Miall 2005 p.311).

Contextual Issues

A single and universally accepted definition of peace has eluded humanity, just as the quest for peace has been one of the preoccupations of humans since the dawn of history. There have been several definitions of peace ranging from the erroneous definition of peace as the mere absence of war to political definitions of peace. The African conception of peace-Ubuntu, will form the basis of our understanding of peace in this context. Ubuntu is an all-embracing African interpretation of peace, which recognises both positive and negative peace. Ubuntu as a concept is widely used in East, Central and Southern Africa, and it offers a more holistic and humanistic conception of peace as it embraces all the dimensions of peace. This African conception of peace recognises the fact that in order to ensure lasting peace some elements should be present. These include “acknowledgement of guilt, showing of remorse and repentance by a perpetrator of injustice, asking for and receiving of forgiveness, and paying compensation or reparation as a prelude for reconciliation and peaceful co-existence” (Francis 2006 p.26). Ubuntu also explains our common humanity as a strong basis for peaceful coexistence: “...I am human because I belong, I participate, I share” (Desmond Tutu, cited in Francis 2006 p.26). This African conceptualisation of peace does not see peace as “only the absence of war, conflict, violence, fear, destruction and human suffering, but also the absence of unequal and unjust structures and cultural practices, about security, democratic participation, respect for human rights, development, social progress and justice” (Francis 2006 p. 27).

Religion, a multi-faceted phenomenon (Bellin 2008), has defied a universally accepted definition, but some scholars have come out with some definitions, some of which will serve as working definitions for this paper. Tunde Famoriti (2007) defines religion as “a systematic indoctrination of people aimed at moderating their mode of behaviour towards responsible interaction and societal growth.” Ugwu (2002) states that it deals with "faith and practices involving the relationship between mankind and what is regarded as sacred". Pali and Wadak (2001) assert that "religion regulates the life of the individual in the society, thereby making the society good for harmonious living". According to Roberts (1984, quoted in Assimeng 1989) religion “may be regarded as including those emotionalised beliefs prevalent in a social group concerning the supernatural, plus the overt behaviour, material objects, and symbols associated with such beliefs”. According to Geertz (1972), religion provides their members with both a model for and model of reality; it plays various roles in peoples’ lives. What this means is that religion provides its members with an ethos, a worldview and values as well as a source of identity and legitimacy, and is also “associated with formal institution” (Fox and Sandler 2004, p.176-7). This conceptualisation complements Bruce Lincoln’s definition of religion, which recognises that religion is a set of collectively held spiritual beliefs articulated in a discourse, perpetuated and interpreted by institutions, communities, and associated practices (Lincoln 2003). Following from this explanation, it can be concluded that since religion to a large extent determines the worldview of its members, it can be argued that adherents of religion may practice politics based on the religious doctrines which they have internalised. A variety of theories of religion and politics also tell us we cannot ignore the role of religion as an attribute of individuals and communities, as an organised interest, and in its institutional connections with the state (Gill 1998; Gill and Keshavarzian 1999; Warner 2000; Ammerman 2003; Manza and Wright 2003; Kniss and Numrich 2007; Philpott 2007).

Conceptual and Theoretical Underpinning

In this section we will discuss the works of Nicholas Wolterstorff, Juergen Habermas and John Rawls, who have been involved in discussions on the interconnection between religion and politics.

Wolterstorff, in his oft-quoted passage, states that ‘it belongs to the religious convictions of a good many religious people in our society that they ought to base their decisions concerning fundamental issues of justice on their religious convictions. They do not view it as an option whether or not to do it... Their religion is not, for them, about something other than their social and political existence.’ (Wolterstorff 1997: 105) This is, however, related to the second, more provocative statement that because of the unbearable burden on religious citizens, we cannot ask them to translate their arguments in the informal public sphere and that the same applies to the public sphere in general, i.e. including formal reasoning in the legislature as well as the judiciary. In other words, religious citizens cannot artificially divide their identity into the private, religiously motivated self and the public self whose acts are based primarily on public reasoning, whereby a person’s public reasoning can even run counter to the same person’s privately held beliefs about proper actions (cf. Yates 2007; Wolterstorff 1997; Weithman 2002 cited in Kratochvíl 2009).

Wolterstorff’s statements indicate that he hotly contests Rawls and Habermas’s positions regarding the role of religion in the public sphere. For Rawls the condition *sine qua non* for a functioning liberal democratic public deliberation is the practical application of publicly accessible and understandable justification: If the state acquiesced to one particular moral doctrine and gave it precedence over another, for instance by granting the arguments derived from this doctrine public validity without recourse to ‘public reason’ (for the definition of this term, see Rawls 1997a and 1997b cited in Kratochvíl 2009), the resulting situation would be either that of a hegemonic position of one particular religious group over the society or the breakdown of public order and an explosion of religious struggle. This obviously does not mean that a stance defended by a religious citizen that is in accordance with his or her religious belief is not permissible at all, but rather that ‘a responsible citizen in a liberal democracy ought not to support (or reject) a coercive law on the basis of religious convictions alone’ (Eberle 2002: 12 cited in Kratochvíl 2009)

In his latest texts on public reason (*The idea of public reason revisited*, and *Introduction to the paperback edition of Political Liberalism*) Rawls developed what he called a ‘wide view of public political culture’ and explained more explicitly to what extent religious arguments are allowed to enter public debate. He thereby introduced his famous proviso which states that reasonable comprehensive doctrines, religious and nonreligious, may be introduced in public political discussion at any time, provided that in due course, proper political reasons – and not reasons given solely by comprehensive doctrines – are presented that are sufficient to support whatever the comprehensive doctrines are said to support. So, religious reasons are not excluded from public debate but they can only be introduced on the condition that in the course of the debate adequate reasons acceptable to all reasonable citizens are also provided. However, in applying this proviso, two further qualifications should be noted. First, Rawls indicates that the proviso does not hold for the background culture. In civil society religious and other comprehensive doctrines may properly play a role, without any restrictions. Secondly, the limits imposed by public reason and the proviso do not apply to all political questions indiscriminately, but only to those ‘involving what we may call “constitutional essentials” and questions of basic justice’. As a result, the proviso is in the first place relevant in the official discourse of judges, legislators, chief executives, and other government officials (Loobuyck et al. Accessed online on September 8, 2012 <http://adss.library.uu.nl/publish/articles/000090/bookpart.pdf>)

Let us turn to the second influential view of religion in the public – that of Habermas. Even though comparative studies of Rawls and Habermas often exaggerate the different stances they take vis-à-vis the role of religion in the public sphere (Yates 2007 cited in Kratochvíl 2009), once we take into account the intellectual exchange between the two (starting from the exchange in 1995: Habermas 1995; Rawls 1995 cited in Kratochvíl 2009), it is clear that their positions demonstrate a great – and growing – similarity. Habermas also draws a clear line beyond which religious arguments are not permissible. In a manner strikingly similar to Rawls, Habermas claims that ‘the institutional

thresholds between the “wild life” of the political public sphere and the formal proceedings within political bodies are also a filter that from the Babel of voices in the informal flows of public communication allows only secular contributions to pass through.’ (Habermas 2006: 10 cited in Kratochvíl 2009) Unlike Rawls, however, Habermas identifies the informal public sphere (nigh synonymous to the Rawlsian background culture) as the appropriate locus of translation of particular reasons specific to individual (not only) religious groups into the publicly accessible language of the formal public sphere: ‘The truth content of religious contributions can only enter into the institutionalized practice of deliberation and decision-making if the necessary translation already occurs in the pre-parliamentarian domain, i.e., in the political public sphere itself.’ (ibid.) In addition, for Habermas, it is not so much the content of the deliberations in the public sphere that is most relevant, but rather their procedural aspects (Habermas 1999 cited in Kratochvíl 2009). Theoretically, this opens up more space for those who want to defend a political stance grounded in a religious belief. Habermas himself, in his defence of the ‘post-secular society’, cites at least two reasons for which this greater openness towards religious reasons should be supported even by the secular state. The first is a direct response to the split identity objection. Habermas insists that we should not ask religious citizens to give up their private reasoning in the political public sphere if this should ‘endanger their religious mode of life’ (Habermas 2006: 10 cited in Kratochvíl 2009). The second reason points to the (so far) irreplaceable role of religion in the public sphere, where religious actors are often capable of discovering hidden intuitions or of recreating lost elements of meaning and identity (ibid.). Habermas believes that the informal public sphere should be the site of mutual dialogue among different groups with different sets of beliefs where all of them engage in self-reflexive exposure of their values and aim at the translation of their specific principles into a language that would be understandable to outsiders as well. Importantly, this task does not pertain only to religious citizens since it requires that secular citizens also remain ‘sensitive to the articulation power of religious languages’ (Habermas 2002: 71 cited in Kratochvíl 2009). It is exactly the obligation to translate religious reasons into secular terms that is seen as the critical juncture by the opponents of the liberal view of religion in the public sphere. For instance, Paul Weithman (2002 cited in Kratochvíl 2009), among others, criticises Rawls’ requirement of translation as unnecessary and discriminatory. According to Weithman, basing one’s own arguments on his or her moral or philosophical doctrine and being able to give reasons for which the measure advocated is equally good for everyone from the point of that particular doctrine is a sufficient condition for participation in public deliberation. In other words, it is again, as with Wolterstorff, the need for translation into the secular language that is challenged as inappropriate. The three positions towards the role of religion in the public sphere sketched above are summarised in Table 1.

Table 1: The Role of Religion in the Public Sphere

	Position I (Rawls)	Position II (Habermas)	Position III (Wolterstorff Weithman)
Distinction between formal and informal public spheres	Yes	Yes	No
Formal public sphere/public	Secular reasons	Secular reasons	Non-secular reasons
Informal public sphere/background	Non-secular reasons dominant	Secular and non-secular reasons	Non-secular reasons

culture			
Locus of translation	Unspecified	Informal public sphere	None

Source: Kratochvíl, P. The Religion-Politics Nexus in East-Central Europe: Church in the Public Sphere of Post-Secular Societies. *Perspectives* 2009 Vol. 17, No. 2

It is clear that there is a broad overlap between Rawls and Habermas in terms of justificatory liberalism (the grey fields in the table) – for both of them, (1) advocacy of a measure is justified in the formal public sphere as long as it is supported by secular reasons; (2) in the informal public sphere, the plurality of voices can include non-secular reasons as well; and, as a consequence, for both, (3) the distinction between these two types of public reasoning is vital. The most important difference between them, on the other hand, lies in Habermas’ assertion that the informal public sphere is the place where translations from one language into the other must take place. In this sense, the Rawlsian background culture is more restrictive than the Habermasian informal public sphere. While background culture is primarily concerned with discussions within particular associations (e.g. churches) (Rawls, 1997: 99 cited in), Habermas sees the informal public sphere as including both deliberations within these bodies and deliberations between them. Hence, a mixture of secular and non-secular reasons is present in the informal public sphere as the particular associations try to enter into dialogue with other associations and hence feel the need to translate their reasons into terms that are intelligible for citizens with other comprehensive doctrines. Position III in the table 1 above starts from the premise that there is no need for that kind of translation. As a result, the distinction between the two kinds of public spheres is not necessary, and reasons based on comprehensive doctrines can be present in public deliberations of any kind, including those of legislators and the justice.

Data and Methods

Data for the study were collected through survey questionnaire and in-depth interview from functionaries of political parties, who were resident in the Cape Coast Metropolis and in the Kumasi Metropolitan Area. The questionnaire was made up of two main sections. The first section covers the socio-demographic characteristics of respondents and includes their age, sex, marital status, religious affiliation and ethnicity. The second section consists of specific issues such definitions of the terms “religion”, “politics” and “peace”, the interrelationship between the three terms, the political atmosphere in Ghana and the role religion plays in politics. Field assistants, who collected the data, were two in number – a Research Assistant and an Assistant Lecturer, both from the Department of Sociology and Anthropology of the University of Cape Coast. Before the administering of the questionnaire and the conduct of the interviews, the instruments were discussed with the Field Assistants, after which they were pre-tested. The pre-testing was undertaken to remove all possible ambiguities. After that the actual collection of data started. The purposive sampling and snowball techniques were used to select party executives for the study. The snowballing method helped the researcher to have access to students of the University of Cape Coast who were party executives from the various constituencies across the country, while the purposive sampling technique was used because of its convenience in helping reach out to the respondents. In all, 60 questionnaires were administered but only 44 could be used for the study. This is because some of respondents did not complete the questionnaire because they claimed that they did not have time to do so due to the numerous political activities that they had to undertake; others claimed that the questionnaire was too demanding. Data from the field were edited, coded and analysed with the aid of the Statistical Product for Social Services (SPSS).

Results

Socio-demographic background of respondents

This section provides information on the socio-demographic characteristics of the functionaries of political parties and covers age, sex, marital status, ethnicity, religious affiliation, level of education and profession (Table 2). The data indicate that the respondents were mostly male political parties' functionaries (77.3 percent). The majority of the respondents were Christians (77.3 percent) and 40.9 percent were Akans. The results of the data regarding the religious affiliation and ethnic background of the respondents support the data from the 2000 Population and Housing Census report of Ghana which indicated that the majority of Ghanaians were Christians (69 percent and belonged to the Akan ethnic group (49 percent) (Ghana Statistical Service 2002). The majority of the respondents were in the teaching profession (50 percent)

Table 2: Socio-demographic profile of respondents

Age	Frequency	Percentage
Below 20	4	9
20-24	5	11.4
25-29	16	36.4
30-34	9	20.5
35-39	4	9
40+	6	13.6
Total	44	100.00
Sex		
Female	10	22.7
Male	34	77.3
Total	44	100.00
Marital Status		
Single	28	63.6
Married	16	36.4
Total	44	100.00
Religious affiliation		
Christianity	34	77.3
Islam	7	15.9
Traditional African Religion	1	2.3
Other	2	4.5
Total	44	100.00
Level of education		
Middle School	3	6.8
Secondary	9	20.5
University	29	65.9
Others	2	4.5
No education	1	2.3
Total	44	100.00
Ethnic Background		
Ga-Adangbe	1	2.3
Ewe	7	15.9
Mole-Dagbani	3	6.8
Guan	8	18.2
Akan	18	40.9

Others	7	15.9
Total	44	100.00

Profession

Clergy	2	4.5
Teaching	22	50
Engineering	2	4.5
Other	18	41
Total	44	100.00

Respondents' understanding of the concepts religion, politics and peace

Analysis of respondents' explanation of religion revealed two general themes: religion has to do with an individual's identification and relationship with God or a supernatural being; and a belief system that unites people towards the worship of a supernatural being. In the explanations provided by respondents' on politics, two themes emerged, too. First, politics has to do with the expression of divergent views and decisions about the utilisation of resources to the benefit society. Second, politics is about the struggle for power, leadership and governance of a country. Respondents' understanding of peace reflects some of the widely-held views of peace. Their definitions were centered around the following: a state of being secured; living cordially and harmoniously with one another; having equal rights, experiencing justice and being tolerant in the face of divergent opinions; and the absence of conflicts and wars.

Interrelationship between religion and politics

The views of respondents were sought about the interrelationship between religion and politics. When asked whether there is an interrelationship between religion and politics, 30 respondents representing 68.2 percent responded in the affirmative, while 22.7 percent of them responded in the negative. Another 9.1 per cent could not tell whether there existed any relationship between religion and politics, so they opted for the option: "Don't Know." Some of those who believed that there is an interrelationship between religion and politics offered explanations such as: *religion and politics complement each other to ensure the survival of society; people elect or vote for leaders based on the fact that those individuals belong to their religion, without necessarily considering the capabilities of those personalities; both religion and politics are preconditions for social order, progress and development; and religion teaches about morality and morally upright politicians serve their people very well.*

Religion teaching about politics and peace

Data on whether religion generally teaches about politics revealed that as many as 61.4 percent of the respondents thought that religion teaches about politics, while 31.8 percent did not think that religion teaches about politics. Three respondents (6.8%) did not know whether religion teaches anything about politics. With regards to respondents' views on whether religion teaches them about peace, the study revealed that an overwhelming majority (97.7%) indicated that religion teaches them about peace, while 2.3 percent could not tell whether or not religion teaches about peace. The views of the majority are captured in the explanation given by a 54 -year old man who was a party chairman for one of the political parties in Cape Coast:

I belong to Islam and Islam means peace; Islam teaches us to worship God, love our neighbours, to forgive those who offend us so that God can also forgive us when we sin against him.

Knowledge about religious persons deeply involved in politics and their impact

An investigation into whether respondents knew any religious persons, who were deeply involved in politics, showed that 65.9 percent know about people like that in the country, while 20.5 percent did not know of any such persons. The remaining 13.6 per cent could not give any answer. Those, who stated that they knew such personalities, mentioned the following names: the late President J.E.A. Mills, Rev. S.K. Boafo and Prof. Mike Ocquaye, Mr. Acquah of Cape Coast who was an executive of the Progress Party, Alhaji Karim of Kojokrom in the Western Region of Ghana, who rose to become the National Youth Organiser of the National Democratic Congress (NDC) and Hon. Samuel Ofori Ampofo.

As regards the impact these politicians have made in politics, twenty-six respondents (89.7%) stated that this category of politicians have made some impact in politics as well as in the enhancement of their religion. Only one respondent (10.3%) believed that they have not made any impact in the political arena. Alhaji Karim and Mr. Acquah were cited as people who helped their people so much, by providing them with a mosque and a church building respectively. This was how one of the respondents described the impact made by the late President Mills:

He really brought sanity and changed the face of politics in Ghana through incessant preaching of peace, unity, as well as calling for politics devoid of vindictiveness and use of dirty and inflammatory language.

Religious persons and the promotion of peace in politics

The views of respondents on whether religious persons are likely to promote peace in all their endeavours, including the political arena, revealed that of the 29 respondents who answered this question, 26 (89.7 percent) thought that such persons are likely to promote peace, while exactly 10.3 percent did not think that religious persons are likely to promote peace. Those who believed that religious persons are likely to promote peace in politics explained that because religious people are taught to lead peaceful lives and promote peace always, they are likely to do this when they enter the politic arena. Their views could be summed up in what one of them between the 25-29 age bracket said:

Since most of our religions teach us about peace, I think religious people can help to promote peace knowing well that their beliefs or faith prohibit violence or conflict.

The only respondent who answered “no” to this question said:

If religious persons go into politics they cannot promote peace because they will definitely compromise and cannot help but to lie sometimes and steal some moneys that belong to the state.

An investigation regarding the promotion of peace while practicing politics, revealed that a little over 77.3 percent promoted peace as they practised politics; while 9.1 percent observed that they did not make efforts to promote peace. Only one respondent (13.6%) was not sure as to whether or not he promoted peace. Those who stated that they did not make any efforts to promote peace as they went about their political activities could not provide any reason(s) for their answer. On the other hand, those, who indicated that they promoted peace, said they did that by toleraing dissenting views and advising members of their parties not to view their political opponents as their enemies.

With the overwhelming view that religious persons are likely to promote peace in the political arena, it was therefore, not surprising that 29 of the respondents representing 65 percent felt that it is proper for religious people to get actively involved in politics, while 31.8 percent thought otherwise. The remaining 2.3 percent could not tell whether or not it is proper for religious persons to get actively involved in politics.

Politics and religious conviction

The respondents' political behaviour and their religious conviction were also investigated. The results showed that 52.3 percent practised politics based on their religious conviction, while 25 percent do not practise politics based on their religious conviction. The remaining 22.7 percent could not tell whether or not they practised politics based on their religious conviction. Those, who said they practise politics based on their religious conviction, explained, among others, that their religion enjoins them to treat people with dignity, so even in politics they tried to abide by that. They did that by treating their political opponents with respect and not hurling insults at them. Others explained that they got involved in politics to better the lots of the less privileged in society. To them helping the less privileged in society is a virtue which all religions teach.

Conflict in Ghana's political landscape

The study also sought to establish whether the political arena in Ghana is characterised by conflicts. Thirty-six respondents representing 81.8 percent stated that the political arena is characterised by conflicts caused by and large by politicians, foot soldiers of political parties, the youth and the media, while 15.9 percent thought otherwise. 2.3 percent said they did not know whether or not there was political tension. To those, who stated "Don't Know", what seemed to be a conflict(s) were mostly only verbal confrontations, which usually happened during political discussions on radio. They believed that such verbal exchanges would hardly degenerate into violent conflicts. However, some of them noted that there had been a few instances where people had been injured, while others had lost their lives due to political clashes.

Suggestions to solve the tension in the political arena

The respondents who believed that the political arena is characterised by conflicts made suggestions as to how to solve the problems. The data revealed that 50 percent of them thought that by educating people, particularly politicians, to understand that politics is about the contest of ideas and not insults, the charged political atmosphere would be a thing of the past. 13.9 percent of respondents were of the view that people who do not conduct themselves well during political discussions and campaigning should be sanctioned. Some other suggestions included: the preaching of peace by politicians and religious leaders, tolerance for dissenting views, creating proper avenues for reconciliation, training security officials, particularly the police charged with the responsibility of maintain law and order, to be impartial in the discharge of their duties, etc. Table 3 below presents the suggestions provided by the respondents.

Table 3: Suggestions on how to solve the conflicts in the political atmosphere

Suggestions	Frequency	Percentage (%)
Education	36	50
Sanctions	5	13.9
Delayed Broadcasting	3	8.3
Politicians/ religious leaders		
Should preach peace	2	5.6
Tolerating diverse views	2	5.6
Proper avenues for reconciliation	2	5.6

Impartial security officials	1	2.7
Voting for genuine/ peace-loving Politicians	3	8.3
Total	44	100

Source: Field Survey, 2012

Discussion and Conclusion

The results of the study show that respondents had a very good understanding of the concepts of religion, politics and peace. This is because their explanations of the concepts are largely in consonance with what is found in literature. For instance, the explanation of religion with reference to a supernatural entity as the ultimate object of worship or reverence, is in consonance with Zanden's (1990 p.286) definition of religion as "those socially shared ways of thinking, feeling, and acting that have as their focus the realm of the supernatural and beyond." Again, the themes that came out of the explanation of peace reflect the all-embracing African conceptualisation of peace as expressed by the concept "Ubuntu" (Francis, 2006).

The findings also revealed that the majority of the respondents believed that there is an interrelationship between religion and politics. Because of this religion can influence people to become good politicians. Indeed, in the traditional African setting religion did influence the chiefs, who were the political leaders to protect the people and promote peace and harmony. However, in Ghana's current democratic dispensation, religion has not been influencing most politicians to protect the people and promote peace and harmony. The result is that the political temperature is very high in Ghana. Disequilibrium and alienation are on the ascendancy and Ghana has become uprooted. Politicians insult each other and there is a lot of chaos and anarchy because people want to win power at all cost. Ghana's condition cannot but cause disquiet and anxiety. Friction and frustration are undermining the Ghanaian society. If we try to ascertain the reason for this, "and seek an answer exclusively in the political or economic realm (as most scientists have done until now), we will not find the solution to this malaise. This is because the problem is neither purely political nor merely economic, but is an existential one. That is why several scholars have attributed the origins of this contemporary political, economic, and social malaise to secular politics (i.e., where legal and religious activities must be separate and one should not affect the other domain)" (Cristini 2007: 575).

This study seeks to point out that the current political philosophy inherited from Machiavelli, who separates morality and politics, is a perennial source of political problems in Ghana. For many Ghanaian politicians, what they do to gain power does not really matter. What matters is that they gain power through fair or foul means. With them, the end justifies the means. Because of this, hardly can anyone deny the pervasiveness of corruption, nepotism and wickedness in the country. Moral turpitude and vileness have become so insidious in the country that they have become part of the "normal" life among citizens. Kola Owolabi captures the matter when he argues that "moral bankruptcy has pervaded every section of the [Ghanaian] society to the extent that one may be forced to reach the conclusion that immorality is a cultural trait of the people" (Owolabi 1995 cited in Agulanna 2010). According to Chinua Achebe, Africa's problems, and for that matter Ghana's, stems from the fact that the leadership is corrupt. He reasoned that "leaders ought to be a group of educated people moved with great passion. The danger and destruction you see in Africa which has so much human and material resources and spiritual resources, is as a result of misguided leaders. Look at the wealth of our culture; we have taught the world that mankind began there. If you don't have leaders which understand this, you are doomed" (Achunike 2008).

“Seeking solutions to these problems through political means alone will not address the question holistically. In order to do this in a satisfactory manner, one needs to be concerned with the relationship between politics and religion, that is, the spiritual dimension of human life. What needs to be undertaken is the reintegration of religion into politics” (Cristini 2007: 575). It is only through this reintegration that Ghanaians, particularly politicians, will be motivated to be selfless rather than protecting their self-interest and sacrificing the interests of others. They will master their ego and its desire for inordinate power, which has disastrous consequences (Cristini 2007).

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THINKING OF PEACE, DEMOCRACY AND POLITICS OF INSULTS IN GHANA: THE PARADOX OF FREEDOM AND CULTURE OF VIOLENCE

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Abstract:

Ghana is perceived as a peaceful country in a volatile region and prides itself of becoming a middle-income country in a foreseeable future. Considering the political climate of Ghana as opposed to other countries in the West Africa-sub region including Nigeria, Cote d'Ivoire, Liberia and Sierra Leone among others, Ghana can be said to be a 'small heaven' in a conflict endemic sub-continent. Having experienced most coup d'états and political summersaults after independence in 1957, Ghana is now a democratic country and regulated by the Republican Constitution of 1992. The liberalization of the airwaves, coupled with the practice of multi-party democracy, has given the citizenry the opportunity and freedom of speech and freedom of association.

However, a critical observation and monitoring of the events in Ghana in recent times have revealed that, due to freedom of speech, the political landscape of the country has become a theater of most vitriolic insults especially from politicians and their cronies which poses threat to the democratic peace enjoined in the country.

The position of this paper is that unless pragmatic and concrete efforts are made to transform the political landscape of Ghana, the democratic freedom of the people will gradually but steadily trap the country to a state of insecurity.

Key Words: Peace, Democracy, politics of insults

Introduction

Like most societies around the globe, Ghana is perceived as a stable a country in a volatile region. Considering the political climate of Ghana to other countries in the West African sub-region including Nigeria, Cote d'Ivoire, Liberia, Sierra Leone and Guinea among others, it will not be out of context to conclude that Ghana is indeed a 'small heaven' in a conflict endemic sub-continent.

Having experienced most coup d'états and political summersaults after independence in 1957, the country is now regulated by the Republican Constitution of 1992 (Ghana's Constitution). The formation of political parties and the practice of multi-party democracy to some extent have given the citizenry the opportunity to join any political party of choice and the exercise of franchise. The institutionalization of the local government and administrative system (decentralization) coupled with the liberalization of the airwaves has encouraged and broaden the participation of the masses in decision-making in matters that affect their interest.

To ensure the attainment of peace, security and stability, Ghana has established various regulatory and adjudicating bodies including the police, the military and the adversarial courts. Besides, other adjudicating bodies including the Commission on Human Rights and Administrative Justice and Labour Commission have been established to ensure that the fundamental human rights of the individual are not trampled upon by any person or body as enshrined in the 1992 Republican

Constitution. The philosophy is to ensure that law and order prevail in the country and that no groups of individuals take the law into their own hands so as to plunge the country into chaos.

Thomas Hobbes, a 17th century political thinker could be right when he argued that, the absence of social control in a society was a recipe of chaos and anarchy (Beilharz, 2000). A regulated conduct is considered a healthy practice for the over-all growth and development of any human society at any given time. One thing which is certain is that, every society that has ever existed has recognized the need for laws. These laws may be unwritten, but even pre-industrial societies had rules to regulate the conduct of the citizenry (Gulliner, 1979).

Regrettably, the seemingly efforts made by Ghana to maintain peace and stability is steadily threatened by democratic ethos of freedom of speech. The political landscape of the country has become a theater of most vitriolic insults especially from politicians and their cronies. The simple pointer is that the peace enjoined in the country has been taken for granted by many Ghanaians, culminating in the culture of violence.

The position of the paper is that, peace cannot be acquired automatically neither can it be implanted by any external body. It has to be primarily planted and nurtured by the people concerned. The paper posits that unless democratic value of freedom of speech is regulated by its sister principle of responsibility/duty, the freedom of speech as enjoined in Ghana could breed culture of violence and robbed the peace of the country. The paper therefore sought among others to examine the extent to which politics of insult, an off shoot of freedom of speech which is embedded in democracy, poses threat to the peace of Ghana.

The paper is structured into four broad headings/sections. The first section is devoted to the introduction. Section two looks at the concepts; 'peace', 'democracy' and 'politics of insults' as well as their interconnectedness. Section three focuses on the methods and techniques employed in gathering and analyzing data. Section four captures the conclusion and suggestions made as part to promote and maintain democratic freedom of speech in Ghana without necessarily breeding the culture of violence.

Conceptual Definitions

This aspect of the paper focuses on the explanation of the key words relevant to the study. In this regard, peace, democracy and politics of insults have been discussed. The purpose is to fine-tune our understanding of these concepts and their implications as they manifest in our contemporary political lives.

Peace

The concept peace has become a household word in our conflict endemic world. Peace features prominently in political campaign messages, religious songs, prayers and libation. Interestingly, the concept lacks a universally accepted definition. However, like many theoretical terms such as happiness, harmony justice, and freedom, peace is something we recognize by its absence (Barash and Weber, 2009).

In some quarters, peace is equated to the absence of conflict, for that matter war. Pacifists agree to this conception of peace (Oliver, 2008). Those who view peace from this narrow perspective (negative peace as proposed by Galtung), tend to associate the absence of violence (conflict behaviour) with the absence of conflict. This in most quarters and over the years has been the popular understanding of peace.

Peace is a broad term and spans beyond the purview of the ordinary person. As indicated by Edwin Stettinius in 1945, the then US Secretary of State; *'The battle for peace has to be fought on two fronts. The first front is the security front, where victory spells freedom from fear. The second front is the economic and social front, where victory means freedom from want. Only victory on both fronts can assure the world of an enduring peace'* (quoted in, Brown *et al*, 2007:1).

Many people on the other hand view peace from the angle of justice. Justice in a sense is equated to that of fairness. By implication, a peaceful environment is the one in which individuals are fairly treated (in terms of relations and opportunities) regardless of their ethnic origin, political affiliation, social status or economic standing among others. Discrimination, marginalization and all forms of ill-treatment in this regard are seen as fruits of an unjust society.

Conversely, justice is conceived by many from the retributive stand point. That is, visiting the evil doer by evil. As stated by St. Augustine (cited in Twumasi, 1985:11), 'Punishment is just for the unjust'. The fundamental idea is that the criminal must not go unpunished. Those who view peace from this perspective assume that, society cannot enjoy the desired peace if individuals are left to do whatever pleases them to the detriment of the masses. The establishment of courts and prisons (criminal justice system) may underscore this view of peace.

Judging from the above explanations, on a more expanded form; safety, welfare, justice, prosperity and respect can be seen as essential ingredients of peace. In this regard, peace in a sense may be construed as a state of being devoid of destruction, fear, harm, threat, or physical attack. It is a broad term which covers human development in the area of human rights, political freedom and opportunity to lead a long and healthy life, as well as environmental and other aspects of sustainability. Oliver (2008) indicates, in contemporary context it is clear that any discussion on peace as opposed to war and conflict must also connect with research and policy on development, justice and environmental sustainability.

It must be emphasized that, peace is neither acquired nor achieved automatically. It has to be planted and nurtured by the people. In the words of Eleanor Roosevelt in a Voice of America Radio Broadcast; 'It isn't enough to talk about peace; one must believe in it. And it isn't enough to believe in it; one must work at it' (SDA Adult Sabbath School Teachers Bible Study Guide, January-June 2010, p.41). In the view of Bennett (1991), a statement of goals for an organization guarantees nothing toward the fulfillment, and if the goals have real importance or significance for the welfare of the humankind, the process of fulfillment is of greater value than the verbalization of aim. In simple parlance, peace has to be conceived and hatched through action.

Democracy

The term democracy has become so notorious in contemporary political discourse. Given its notoriety and expansive usage, there is a sense that democracy can include every political systems and regimes. The essence of this part of the paper is not to engage in this endless academic war pertaining to the specificity of the term. Nonetheless, it is important for us to understand the term from its original sense, dynamics, usage and practice in contemporary times.

Oquaye (2004) has pointed out that, democracy has become prescriptive phenomenon. It stretches from boundary of a goal, a reality to an illusion, resulting in the justification of any kind of regimes ranging from Nazism, Fascism, Liberalism, among others, to be democratic. A healthy understanding of the term will be helpful in clearing any misapplication and misconception held about it by people in recent times.

Democracy is derived from the word 'demokratia' from 'demos the Greek word for people and 'kratia' which means power or strength. In its Greek derivative, democracy means the actual and direct participation of the citizens (excluding women, children, slaves and foreigners) in public affairs in the Greek city-state (Oquaye, 2004). In simple parlance, democracy in practice was not the rule of the people but the rule of the section of the people even if the section was the wide majority. Democratic process took in the form of physical gathering in which the citizens took decisions, made laws and delegated day to day management to the officials who reported or accounted to the assembly.

Contemporary usage and practice of democracy which focuses on the rights and freedoms of the individuals as well as the collective interest of the state (common good), calls for re-thinking of

democracy. It is against this background that Abraham Lincoln's definition of democracy as government of the people, by the people and for the people has gained much currency.

Oquaye (2004) however has expressed various sentiments about Lincoln's definition of democracy. He contended that Lincoln's conception invokes every idealistic situation imaginable, and that the definition is bedeviled with difficulties. Perhaps only the expression 'government for the people' does not beg for clarification as it may be taken to mean a government in the people's interest, for their benefit. He opines the expression 'by the people' does not tell us in what sense this is to be understood or the means of achieving that objectives. It is enigmatic to observe a government which has come to power by the barrel of the gun insisting that it is government by the people. He noted 'government for the people' could have several meanings; (i) it may connote a self-government as opposed to a colonized people; (ii) a direct democracy; (iii) conversely that the people are the object of government, that they are governed; (iv) that the government belongs to the people; (v) that the government is chosen and guided by the people; (vi) that the government is responsible to the people; and (vii) that the government emanates from the people in the sense that it derives its legitimacy from the people's consent. He views democracy as a system of governance connoting freedom to elect one's own representatives, directly and without hindrance. A legitimate government based on consent and rules in the interest of the people.

Oquaye's view of democracy has highlighted the nature of relationship that has to exist between citizens and the ruler in any meaningful democracy. The understanding is that any political system claiming to be democratic should afford the citizens the freedom to elect their own leaders who in turn serve the interest of the citizens, individually and collectively. More so, the relationship between the citizens and the ruler is legitimately regulated.

Windsor (2007) opines that democracy is about electoral processes and all that is necessary for elections to be fair and meaningful; free association, free speech, and an independent and professional news media. It involves a broad range of vital institutions including the judiciary, a meaningful legislative body, and security forces that defer to the authority of elected civilian leaders whose purpose is to serve and protect the people. Democracy is also about laws and behaviour that reflect democratic values, which means respecting internationally recognized human rights; protecting minority rights in addition to majority rule; tolerating ethnic, religious, linguistic and political diversity; and ensuring freedom of expression. Wilson asserts that although democracy is not a panacea for all ills, it is essentially associated with achieving lasting success in reducing both poverty and insecurity.

It is evidently clear that there is a striking link between democracy, peace and stability. Urdal (2007) argues that a lack of political right (democracy) may constitute as motive for political violence, that, highly democratic societies are the most peaceful. This point buttresses the assertion that authentic democracies generally promote stability and prevent violent confrontation both within and between states.

The discussion above suggests that contemporary societies cannot think of meaningful peace without re-thinking of democracy. In the words of Windsor (2007), no society ever reaches the ideal, but to abandon the pursuit of a democratic society because it is hard to achieve is a mistake.

Politics of insults

Politics of insults has gained root in our political discourse especially in Africa. However, the serious challenge is that, there is little literature or virtually none on the term 'politics of insults'. An understanding of the twain terms 'politics' and 'insult' is necessary to enable us arriving at a working definition. This in effect will also help us to analyze its implication on the peace of a given country.

Politics affect every facet of our lives. As humans, regardless of our social and economic status, as well as the geographical location in which we find ourselves, we engage in some sort of discussion on politics in our everyday lives. We concern ourselves with issues including: local roads,

schools, systems, supply of water, elections, security of the environment, and news of war among others (Bluwey, 1993).

Aristotle explained that man is a political animal in that he lives in organized human communities or collectivity with regulated relationships and takes decision that affects his very life. Politics is thus, a human property (Heineman, 1996; Britannica online Encyclopedia).

From the foregoing explanation, it can be deduced that, the term politics implies the following: (i) participation in public decision, (ii) the power of a state (iii) position or political office/political appointment, (iv) about a regulatory body known as the government, (v) involves institutions, example; parliament, judiciary, court, etc.

The Longman Dictionary of Contemporary English (p.741) explains insult as a rude or offensive remark or action to offend. The same dictionary (p.979) explains offend (the verb form) as to make someone angry or upset, unpleasant or to hurt feelings. The Cambridge Advanced Dictionary (664) equally defines insult as an offensive remark or action, or to do something that is rude or offensive.

To Curle (1995), violence is something which does harm to people; harm in the sense of words, deeds, or situations which damage the ability to develop fully the human potential for feeling, creation and happy maturity (1995). From Curle's explanation of violence, insults could be interpreted as violent acts as they aim to offend a person.

On the basis of the explanations above, politics of insults could be explained as a political climate or environment clamoured with verbal expressions which are meant to attack, provoke and dehumanize a person especially political opponent, which has the tendency to illicit negative reaction or response in the form of verbal attack or physical violence. In this vein, all forms of provocative speech, hate speech, inciting speech and indecent words which tend to belittle, criminalize and condemn political opponents are conceptualized as politics of insults. Democracy is founded on the principle of mutual respect. In a situation where freedom of speech is used as a weapon to scandalous political opponents or inciting political supporters to act in a violent manner, is a first sign that democracy is at risk, a recipe of chaos and insecurity.

Politics of insults is inimical to peace as it creates dis-unity, foster strong sentiments and galvanized faction building among citizens. The infamous Rwanda genocide for instance might have had its own root causes (Allan, 2007; Hintjen, 1999; Meadow, 2009; Kellow and Steeves, 1998). Nonetheless, they all acknowledged the fact that the hate speech (call to fight, kill, defend, *inyenzi* meaning cockroach, etc.) perpetrated on the Rwanda Radio, especially Radio-Television Libre des Mille Collines (RTLML), did contribute in deepening animosity and fuel the violence in which several people were massacred with impunity.

Authentic democracies may avoid violence, for that matter, war. Yet, the seeds of peace have to be sown and nurtured by the people as they are not achieved automatically.

Methodological consideration

The objective of the paper was to explore the extent to which politics of insults as embedded in freedom of speech has eaten into the Ghanaian political landscape and how such political climate poses threat to the peace of the country. On the basis of the objective of the paper, data sources were mainly secondary and gathered through critical review of some speeches made by some members of the executive, the legislature and other leading political figures/politicians on the Ghanaian media (especially the radio), as they mainly serve as the platforms for politicians to chastise their opponents. The justification for such selection was that these personalities hold influential positions in the country, and for that matter, any speech made by them carries more weight and has much influence on the populace. In order to get a broader view and understanding, other literature works pertaining to democracy and peace, as well as the media and violence, relevant to the topic were equally reviewed. The study took place between June, 2011 and December, 2012.

The study was basically qualitative in nature. In view of this, data were analyzed by using the technique of thick descriptive. It is expected that in future a more in-depth quantitative studies will be conducted by other researchers to establish the actual or otherwise correlation between freedom of speech and violence in the country.

Discussion and findings

The discussion focuses on the extent to which politics of insults in the name of freedom of speech has gained root in the Ghanaian political landscape and how irresponsible freedom poses threat to the peace in the country. For want of space, only some verbal expressions made by some leading politicians in Ghana have been selected and analyzed.

The Paradox of Freedom and Culture of Violence

How can democracy present both freedom and violence at the same time? Data gathered have revealed that democracy presents both freedom and culture of violence as experienced in Ghana. With a chequered political history since independence in 1957, Ghana is now democratic and peaceful. The liberalization of the airwaves coupled with the abolition of the criminal libel law, has broken what authorities refer to as the 'culture of silence' in the country. The average Ghanaian now has the freedom to express himself in any matters of political interest which was considered unthinkable in the military regime. Ironically, such freedom is gradually breeding impunity and culture of violence in the country. All forms of deadly pronouncements, blatant incitement and reckless resort to hate speech by leading politicians and their supporters are peddled on the media especially the radio. As these medium have the power to influence their listeners, any suicidal speech made in the country cannot be underestimated, bearing in mind the role of the media in the Rwanda genocide.

In the Ghanaian political context, a political opponent is largely considered as a sub-human who needs no recognition and sympathy. Mutual respect, a basic ingredient of human security is virtually out of the vocabulary of most people both young and old. According to Nelson-Jones (2003), respect from the Latin 'respicere' means 'to look at'. That is, looking at others as they are and prize their unique individuality. If Nelson-Jones assertion of respect is to go by, then Ghanaians with their abusive political language and intolerance are mainly beating the drums of violence. For a former president of Ghana, John Rawlings to ironically referring to a fellow president John Agyekum Kufour as 'Ata Ayi' (a notorious armed robber in Ghana) without any justification, was not only unfortunate as lamented by Abrefa Damoa and many Ghanaians (modernghan.com, 2010) but points to how politics of insults have deeply rooted in the Ghanaian political culture.

The political landscape of Ghana has become theater of most vitriolic insults and intolerance. Given the political landscape of Ghana, the 2012 National Patriotic Party (NPP) Presidential Candidate Nana Akufu Addo Dankwa remarked, 'All die be die'. This has become a major slogan among people of political divides in recent times (www.peacefonline.com, July 6, 2012; Joy News TV, July 21, 2012; General News, July 2, 2012). Even though, a section of the Ghanaian populace has condemned such unguarded pronouncement as unfortunate as it calls for the party supporters to defend themselves, the reality is that it is a reflection of the deadly path chosen by politicians and their cronies which ought to be reversed to save the country from any catastrophe.

Most Ghanaian media houses have become platforms for politicians and their supporters to dehumanize, criminalize and condemn their political opponents (GNA, 2012). A weekly monitoring of 31 radio stations by the Media Foundation for West Africa (MFWA) before Ghana's Parliamentary and Presidential elections in December, 2012, using Intemperate Barometer, revealed that, hardly a week passes by without political leaders and their supporters engaging in politics of insults in the form of; provocative remarks, call to fight or violence, promotion of disunity, and 'expression connoting tribal slur', among others. For instance, between April 8th and 14th, 2012, twenty-nine (29) indecent expressions were recorded on 15 radio stations across the country with the NPP and the NDC considered the worst offenders (myjoyonlin.com, 2012).

The proliferation of politics of insults and its ramification on the peace of the country has attracted condemnation and comments from various personalities and bodies including the Ghana Journalist Association, the National Peace Council, Religious Bodies, Civic Forum Initiative (CFI), the Vice President John Mahama Dramani-now the President of the country among others, calling for an end to such intemperate behaviour (GhanaWeb,2012; Ghana News Agency (GNA), 2011 and 2012; myjoyonline.com, 2012; CFI, 2012; OSIWA,2012).

The study had revealed that most politicians in the country have taken the democratic peace enjoyed in the country for granted. On the 8th of December, 2012, while presidential and parliamentary elections were still in progress, the NPP Secretary General, Kwadwo Owusu Afriyie reportedly organized a press conference in Accra and apparently charged the party supporters to celebrate as the Party's presidential candidate, Nana Akufo Addo Dankwa was in the lead in terms of votes cast, an indication that he has already won the presidential election. Such expression was offensive and deadly bearing in mind the consequences of self-proclaiming victory as witnessed in Kenya between incumbent president Kibaki and opposition leader Odinga in 2007, as well as in Cote d'Ivoire between the then president Gbabgo and the current president Quattara in 2010. The provocative speech made by the NPP could have elicited more violent response or reaction from the supporters of the other political parties which could have marred the whole electoral process and the peace of the country. It was therefore not strange when the National Peace Council immediately condemned such behaviour, describing it as unfortunate and premature. The Council noted that such pronouncement could have likely plunged the nation into chaos (GBC News, December 9, 2012; CITIFMONLINE.COM, December 9, 2012). What made such proclamation strange was that all the political parties which contested the 2012 elections were privy to the Political Parties' Code of Conduct which mandated the Electoral Commission (EC) as the only legitimate body to declare electoral results (IEA, 2012; C.I 15, 1996). Yet, the NPP went ahead in declaring itself the winner of the presidential election.

The sense of decorum has eluded many Ghanaians, an indictment of the country's democracy. It is recorded that the NDC Secretary General, Asiedu Nketia, apparently referred to John Rawlings, a former president of Ghana and founder on the NDC as a 'barking dog' (myjoyonline.com, August 11, 2011). This offensive remark needs much to be desired. The question is, if not freedom of speech in the name of democracy, what can best explain the appalling behaviour of most politicians and their supporters which of late has clamoured the political live of Ghanaians? Ken Agyapong, Member of Parliament (MP) was reported to have issued a strong warning on Oman FM, a radio owned by him to the effect that, he has declared war with immediate effect. He also warned of serious consequences at Odododiodoo in Accra within 20 days and warned the national security to take note. He claimed the police have failed in their duty to protect the citizenry (myjoyonline.com, July, 2012). The Honourable MP's pronouncement was dangerous and raised a serious argument about freedom of speech. His claim of the ineffectiveness of the police to protect the citizenry if true, suggests that, a democratic state with weak institutions can itself invent the opportunity for people to foment violence.

Conclusion

Even though Ghana enjoys some amount of comfort and peace as a result of democracy, the study had revealed that irresponsible freedom of speech has resorted in all forms of negative verbal expressions especially peddled on the media and the radio in particular. Such development has exposed the weakness of the country's democracy. Lessons learnt from Rwanda genocide suggests that, politics of insults as deeply rooted in Ghanaian politics challenge the peace in the country and if not curtailed, can trap the country into insecurity. Freedom of speech is a fundamental right but it is not absolute and can therefore not be used as a weapon of destruction.

On the basis of the findings, the under-mentioned points are recommended as part of measures to promote peace, democracy and freedom of speech in Ghana without necessarily engendering culture of violence.

- The Electoral Commission of Ghana (EC) should be legally empowered to withdraw the candidacy of politicians whose pronouncements are considered seeds of destruction
- There should be a regulatory framework that could enable the courts to find leading politicians and their supporters who use abusive words on their political opponents
- The media should be encouraged to blacklist any politician who uses the media as platforms to abuse any political opponent. In the same vein, any media house found guilty of allowing its medium to be used as a platform to scandalous any political opponent should be strongly sanctioned. This demands that the Ghana Media Commission should be empowered to play its role as a monitoring and regulating body
- Politics of insult is a sign of democratic decay. In view of this the necessary institutions especially the police and the court should be reformed/depoliticized to enable them play their protection and law enforcement, and regulating role to the letter so as to avoid a situation where people take the law into their own hands.
- In a pluralistic society like Ghana with different value systems and views, religious and political affiliations, it is imperative for people to learn, appreciate, respect and tolerate one another. The National Council for Civic Education (NCCE) and especially leaders of the various religious faiths, have to embark on rigorous education to impress upon the citizenry to learn to live and tolerate one another in such a multi-cultural social system.

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MARKET ORIENTATION, ORGANIZATIONAL LEARNING, INNOVATION AND PERFORMANCE: KEYS TO THE SUSTAINABILITY OF NON-PROFITS

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Abstract:

The purpose of this paper is to review literature, exploring the relationships between the concepts market orientation, organizational learning, innovation and performance in nonprofit organizations. To understand the nature of these concepts in the nonprofit context, the authors will discuss their application to nonprofit organizations. It questioned the use of management methodologies in these organizations and suggests the investigation of its application to improve its performance. The management of nonprofit organizations should move to another setting, unlike the informality that characterizes them. The question which arises is this reality that these organizations as complex organizations, should strive to implement new management tools that enable them to achieve sustainability, while they seek to achieve their social mission in the universe that are inserted. Thus, the authors propose a conceptual model that relates the concepts above and presents the hypotheses to be tested. They conclude by suggesting the application of the empirical model NPO management as a line of future research. The paper presented, which is part of a broader work of a doctoral thesis, refers mainly to literature.

Key Words: Market orientation, Learning organizations, Innovation, Performance, Nonprofit organizations

Introduction

The social economy and the nonprofit sector appear as a field of growing importance in Europe (Chaves and Monzón, 2001). The changes observed in society in recent decades leading to the need for new forms of management of NPOs in order to balance sustainability and solidarity of those in the long term (Mações, 2010).

Literature is not, yet, a management model applicable to NPOs that encompasses the complexity and diversity of the various factors (Morin et al., 1994; Brunet et al., 1991; Savoie and Morin, 2001). Of existing research on the NPOs (Cutt and Murray, 2000; Morrell, 1986; Kanter and Summers, 1987; Kumar et al., 1998; Sawhill and Williamson, 2001; Baptista and Cristovão, 2004) notes that it is a sector where these are managed so unprofessional.

The literature suggests that profitable firms to be sustainable we must guide organizations to market (Deshpande et al., 1993, Day, 1992, 1994, Harris and Ogbonna, 2001; Kohli and Jaworski, 1990; Kohli et al., 1993; Narver and Slater, 1990, Webb et al.; 2000); should make them innovative (Damanpour and Evan, 1984; Atuahene-Gima, 1995; Damanpour, 1996; Jaworski and Kohli, 1996, Han et al. 1998; Hurley and Hult, 1998; Lukas and Ferrell, 2000) and must be capable of learning

(Baker and Sinkula, 1999a; Hunt and Morgan, 1995; Sinkula, 1994; Sinkula et al. 1997). For the NPO intend to investigate whether the same criteria apply.

In the last two decades the nonprofit sector has undergone various pressures, such as increased scrutiny by the public sector and donors, competition for resources and subsidy cuts. This leads to the NPO give consideration to performance and for the achievement of objectives with the external obtain new features (Duque-Zuluaga e Schneider, 2008).

Main Text

The literature suggests that profitable firms to be sustainable we must guide organizations to market (Deshpande et al., 1993, Day, 1992, 1994, Harris and Ogbonna, 2001; Kohli and Jaworski, 1990; Kohli et al., 1993; Narver and Slater, 1990, Webb et al.; 2000); should make them innovative (Damanpour and Evan, 1984; Atuahene-Gima, 1995; Damanpour, 1996; Jaworski and Kohli, 1996, Han et al. 1998; Hurley and Hult, 1998; Lukas and Ferrell, 2000) and must be capable of learning (Baker and Sinkula, 1999a; Hunt and Morgan, 1995; Sinkula, 1994; Sinkula et al. 1997). For the NPO intend to investigate whether the same criteria apply.

One way to achieve sustainability is precisely through organizational learning. According to Day (1994) is necessary for organizations to have a greater learning capacity due to constant market changes, increasing the information available and the importance of acting in advance to competitors. The market orientation is a form of organizational learning. On the other hand, Slater and Narver (1995) suggest that organizations with a strong culture of organizational learning are much less likely to be dominated by the surrounding conditions of the deal, since they were more flexible and thus can act more quickly to opportunities and adversities which arise. Both concepts of market orientation and organizational learning have received much attention from researchers and managers who consider it a source of sustainable competitive advantage. The relationship between the two has been considered from various points of view. For Hult et al. (2000) is a consequence of market orientation, or as an antecedent of market orientation (Uncles, 2000), but for Baker and Sinkula (1999b) is a mediating variable between market orientation and performance. We believe that to better understand the concepts of market orientation and organizational learning can grasp its indirect influence to the performance and increase the sustainability of NPOs.

Druker (1954) lists another important role in the management of enterprises, it is innovation. This may be in terms of a new product, new service, new process, among others, that produces economic value (Foster and Kaplan, 2001). Innovation and knowledge have become key elements for organizations to be competitive and to ensure adaptation to the globalized world. Its importance is such that Europe stood promoting innovation policies on the agenda of the Lisbon "Lisbon Strategy" with the goal of making the EU the most competitive and dynamic economy based on innovation, able to grow economically in a sustainable way with more and better jobs and greater social cohesion (Frutos, 2008). Taking into account the considerations of the Commission on innovation, this includes new means of production, new forms of management and assimilation, not only in the economic sphere, but also in the social sphere. This implies that besides the technological innovation is an organizational innovation that considers new management models (new forms of organizing in areas such as human resources management, distribution, financial, etc.).

There are some studies that show empirically the positive relationship between innovation and performance (Damanpour and Evan, 1984; Damanpour et al., 1989). In the current context, the changes that have taken place, whether in economic, social and political growth and have led to strengthening of NPOs. These are alternatives to channel civil society efforts in improving the quality of life in view of social development. Why carry out functions of public interest, are increasing their demands, and new challenges for these organizations either in its management or its performance, accountable to society, partners and funders. The NPO, enterprises and government organizations share responsibility for social development. Belonging to a particular universe where social action

divide responsibilities along with the state and private companies, the NPO seeking to innovate in order to ensure their survival and sustainable development. However, unlike what happens with the market orientation and organizational learning, innovation has been absent from models market orientation (Jaworski and Kohli, 1993; Hurley and Hult, 1998). Han et al. (1998) demonstrated that market orientation alone does not make organizations more competitive. On the other hand, Slater and Narver (1995) suggest that market orientation only boosts performance when organizational learning is present. In turn, there are authors who advocate the inclusion of innovation as a mechanism for responding to changes in society.

Currently, most NPOs realized the importance of having effective management because now aware that they cannot survive only on the goodwill of a few, but those forms of market-oriented management, organizational learning, innovation and Performance. Must have a strong concern for the mission, values, vision, and with particular care on the results, looking for leadership development, focus on people, business and pursuit of sustainability (Drucker, 1994). To achieve effective management in the pursuit of sustainability, these organizations need the tools used in organizations profitable (OL). That these tools should be adapted to organizational contexts of NPOs that have some special features that cannot be ignored.

In general terms intend to investigate if the use of a business management influencing sustainability of NPO? We can implement the concepts of market orientation, organizational learning, innovation and performance for NPOs? These concepts allow better performance? Druker (1994) argues that the NPO should be managed business, despite not having a "profit" conventional. They need to learn to use the new concepts of management in order to survive in today's society and thus achieve its mission. However, most of the concepts and tools were originally developed to meet the needs of businesses and little attention has been paid to the characteristics and needs of NPOs distinctive: its mission, which both companies as distinguished from the state; strategies necessary to marketing their services and the necessary resources to carry out its tasks; challenge to the introduction of innovations in organizations that rely on volunteers, manage their performance, among others. Keep an NPO sustainable through good management practices is challenging, but not impossible. It is necessary to have a differential in organizational practices for success in the management and hence the stability of these organizations who present themselves as important agents seeking solutions to the problems of society.

The importance of concepts such as market orientation, organizational learning, innovation and performance has been discussed for several decades (Felton, 1959; Houston, 1986; Levitt, 1969). Druker (1954) is often referred to as the pioneer of literature on market orientation. Since even caught the attention of the customer / user should be the center of the organization, until the recent conceptualization and operationalization of the concept of market orientation (Narver and Slater, 1990; Kohli and Jaworski, 1990; Kohli et al. , 1993; Wrenn, 1996). It is believed that market orientation is a type of organizational culture that contributes to improving the performance of organizations (Deshpande and Webster, 1989; Narver and Slater, 1990; Slater and Narver, 1994; Hunt and Morgan, 1995). Although it is generally accepted that a market-oriented behavior facilitates innovation and that this, in turn, positively influences performance, but there is unanimous agreement among authors. There are empirical studies that demonstrate that there is a positive relationship between market orientation and organizational performance (Narver and Slater, 1990; Ruekert, 1992, Jaworski and Kohli, 1993; Slater and Narver, 1994; Pelham and Wilson, 1996; Van Egeren and O'Connor, 1998), other studies have found a weak (Diamontopoulos and Hart, 1993; Pitt et al., 1996) and others have found no relation (Esslemont and Lewis, 1991; Greenley, 1995; Caruana, 1999).

Given this diversity of conclusions many authors argue that the relationship between market orientation, organizational learning, innovation and organizational performance are not sufficiently clarified and require further investigation (Slater and Narver, 1995; Sinkula et al., 1997; Hurley and

Hult , 1998), indicating that there may be a more complex relationship between market orientation and performance. However, there are also many studies that examined separately in each performance variable (Slater and Narver, 1995; Hurley and Hult, 1998, Han et al. 1998). It was found that there is indeed a relationship between these variables and that directly or indirectly affect the performance of organizations, but the conclusions are not always coincide. While confirming the existence of these relationships no known model that integrates the various variables and analyze its effect on organizational performance. The finding and filling the gaps in the literature is the scope and aim of this study. We intend to develop an integrated conceptual model that can be applied to NPOs and allowing clarify the concept of market orientation and analyze the relationship of the value chain and market orientation - performance, incorporating the variables organizational learning and innovation.

Bearing in mind the current point of research on the relationship between market orientation and performance and that, given the state of the art, the variables market orientation and organizational learning are constituted as a history of innovation, we propose a conceptual model used for profit organizations and that translates the relationships between the variables under analysis to empirically investigate throughout this study. Figure 1 illustrates the research model that we propose to test the NPO:

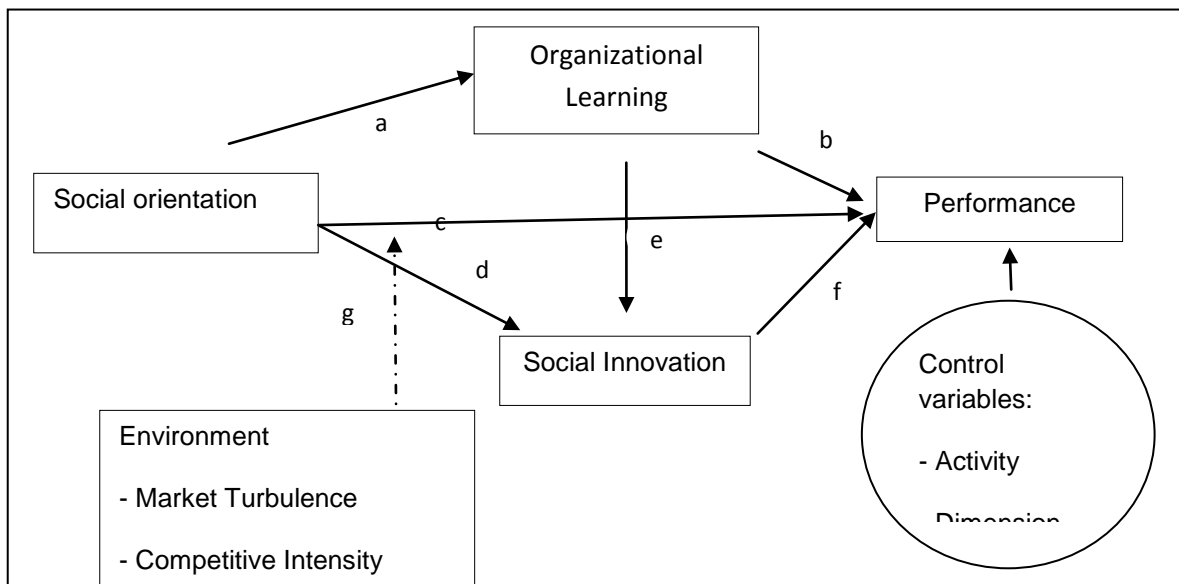


Figure 1 – Model Research

Causal relationships to consider following the model we propose is a direct relationship between social orientation and performance (path c) and links the chains social orientation → organizational learning → performance (path (a) and (b)) and social orientation → social innovation → performance (path (d) and (f)). The paths (e) and (f) represent the relationship between organizational learning → social innovation → performance and the path (g) represents the moderating role of the environment in the relationship between social orientation and performance.

The analysis of the paths intended to show the following:

- i. Organizational learning and innovation are social mediating variables in the relationship between social orientation and performance;
- ii. The social orientation can directly influence the performance (path c) and indirectly through organizational learning (paths a → b) and social innovation (paths d → f);

- iii. Organizational learning can not only directly influence the performance (path b), but also indirectly through social innovation (paths e → f);
- iv. Social innovation can directly influence the performance (path f);
- v. The environment in which the organization operates may have a moderating effect on the relationship between social orientation and performance (paths g → c).

Conclusion

The literature shows that are held in very few research studies that incorporate the variables organizational learning and innovation in the relationship between market orientation and performance. Existing studies have been applied mainly profit organizations, Hurley and Hult (1998) introduced the innovation variable in the analysis of the relationship between the characteristics of the organization and its performance. These recommend that models of market orientation should focus on innovation instead of organizational learning. Rather, Sinkula et al. (1997) suggest that only investigate the relationship between market orientation to learning and performance. It is precisely this effort to link the concepts applicable to organizations profitable and its application in the NPO that aims to underpin this work.

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NEWS STORIES AND THE CREATION OF MYTHS: THE MEDIA PORTRAYAL OF LANCE ARMSTRONG AS A MODERN ICARUS

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Abstract:

Studies on media and myth creation have argued whether mass media takes over the mythological system or mythic products appear only in certain media products, at certain periods of time. This paper enforces the perspective that all media products have a mythic status and examines the role of mass media in myth creation in modern societies through an analysis of the media framing of the cyclist Lance Armstrong as an archetypal figure. By reviewing significant events of his career and life, it is highlighted the process through which mass media portrays Lance Armstrong as a modern hero and furthermore, the role media played in his decay. After defining myth and examining how news stories are presented from the perspective of myth creation, this article analyzes the media-myth of the modern hero created around Lance Armstrong. The research strategy involves a qualitative content analysis of a set of journalistic texts collected from the American newspaper *New York Times*. Nowadays, modern societies are in need of constant new creations of mythological products to relate to. The media act as storytellers and have a vital role in creating myth products that evoke archetypal figures. This paper reinforces the fact that all media products are creations having a mythic status and that the function of mass media in modern societies is similar to the function of the institutions that produced myths in ancient societies.

Key Words: Media, myth creation, hero archetype

Introduction

The studies on media and media creation can be approached from two different perspectives. The first approach has derived from the evolutionist paradigm and states that, in modern societies, mass media act as a system that has taken over the functions of the institutions producing and passing on myths in ancient societies. The other approach is that mythic products appear at certain periods of time, only in certain media products (Rothenbuler & Coman, 2005).

This paper is based on the first theoretical model, derived from the evolutionist paradigm: modern media operates as a mythological system and fulfills the same role that was played by archaic societies, to create and share myths (Coman, 2003). The role of the media is to produce and pass on mythic products, by taking over the functions of ancient societies (Coman, 2003).

The theoretical background is represented by Mircea Eliade's studies on mythology, by Jack Lule's researches regarding the recognition of "epic perennial schemes" (2001, in Coman, 2007, p. 93) in journalistic texts, and by the essay published by Roland Barthes (1957) in the volume "Mythologies" – "Le Tour de France comme épopée".

The starting point of the analysis further presented in the paper is the following statement: "The Tour reaches, in many cases, an inhuman world: on Ventoux, it has already left planet Earth, it neighbors unknown stars (...) The Tour is a confrontation of characters, it needs individual morality (...) The Tour is the best example I have ever met of a total myth" (Roland Barthes, 1957, p. 106 - 111). According to Barthes (1957), The Tour of France is an Odyssey and participants have to overcome their human limits in order to conquer the mountain.

Lance Armstrong, the cyclist who has seven consecutive victories in this competition, can be seen with no doubt as the mythic hero of the Tour, a part integrating in this total myth. I argue that Lance Armstrong's transformation into a modern hero is also due to the fact that he is the central character of a total myth – the epic called The Tour of France – the evolution of the uncrowned king of cycling thus comes naturally. This paper will focus on the role played by media in building a mythological cyclist, presented as a modern hero whose return to sports represented the beginning of his downfall.

Theoretical perspective

The archaic myth and the mythologizing process in modern societies

Myth can be defined as a narration of “a sacred history, it recounts an event that took place during the primordial time, during the fabulous time of the beginnings (...) the archaic myth is the absolutely true and sacred history of supernatural beings” (Eliade, 1978, p. 5). According to Stith Thompson (1972, p. 173, in Coman, 2003, p. 90), “the myth has to do with the gods and their actions, with the creation and the general nature of the universe”.

People presented in myths are supernatural beings who have sacred powers. By describing these characteristics, the myth “becomes an exemplary model of all significant human activities (...) human behavior and profane activities find their models in the actions of supernatural beings” (Eliade, 1978, p. 6). Thus, it can be concluded that the main role of myth is to provide exemplary models of men, mythological characters are gods, heroes, beings with supernatural powers, they are not part of the normal, ordinary, everyday world (Eliade, 1978).

Roland Barthes (1957) defines myth, from a semiotic point of view, as a reference to history, both by form and by taking over historical concepts. The world provides the myth with a historical reality, which it restores through mythologizing. Myth has the power to immortalize historical events, things or people, to whom the society returns through reuse. After being mythologized, they lose their historic, ephemeral character and become a part of eternity (Barthes, 1957).

Regarding the myths presented in the modern society, Mircea Eliade (1978, p. 170) states that “certain mythical behaviors survive under our eyes”. Different mythical structures are reused by mass media and transmitted to the public, and “in media one can identify many mythical elements, characterizing ancient societies. Between the elements that make from the media-myth a replacement of the primitive-myth, can be named: social cohesion achieved by being a part of stories that evoke a certain reality or by imitating and idolizing archetypal patterns (Huynen, 1995, p. 142 in Coman, 2003, p. 87).

Moreover, in today's society one can see a “mythologizing process being similar to the one seen in primitive societies” (Eco, 2008, p 225), and the examples of mythologizing from the media are increasing both in number and significance (Eco, 2008). Media imposes in the society mythical structures of the images and behaviors of exceptional people. Modern heroes represent the ideal for an important part of the society, and their mythic behavior represents the well-known desire to overcome the human condition and the limits imposed by nature. Media mythologizes these people by transforming them, by presenting an exemplary image of them (Eliade, 1978).

Another definition of the representation of myths in the modern society is provided by Roland Barthes (1957, p. 179) – “a myth could be everything can be justified through a discourse”. According to the same researcher, the myth could be regarded as a “depoliticized speech”, where depoliticized refers to the real and social structure of human relationships that have the power to change the world.

Jack Lule (2001) believes that each society is based on several fundamental narratives that take the form of archetypes. Because people need these stories to define themselves, by referencing to them, in modern society, the role of archetypes is taken by the news stories presented by mass media. In addition, in modern societies, news stories have the same role as myths had in ancient societies: to maintain social order (Lule, 2001).

The model of the modern hero:

According to Jack Lule (2001), the myth of the hero is the most widespread myth of humanity; it forwards the core values and the ideals of the whole society. Human tendency is to take a life story as a paradigm and to turn a historical character into an archetype (Eliade, 1978). In order to become hero, one must fall into a certain pattern presented by Jack Lule (2001): the future hero should have had a difficult childhood, in a modest family, he or she should be victorious in a confrontation previously initiated, and have a triumphant return. Moreover, the hero leads an exemplary life and becomes a role model for the entire society.

As Jack Lule noticed (2001), sports act as a factory that produces myths in the society since the days of ancient Greece, because they offer drama and conflict, while highlighting the binary opposition: success – failure or victory – defeat. The tales of sports heroes introduce social values and defend social order, offering people a set of guiding values, such as perseverance, sacrifice, fighting spirit and teamwork.

Unlike the classic hero, the modern hero is a media creation, which turns him or her into a celebrity, which is then the subject of marketing and promoting processes. After being offered to consumption for a certain period of time, the hero is discredited and discharged, and his downfall is largely due to the way mass media presents his evolution (Lule, 2001).

Methodology

The research strategy involves using a qualitative content analysis in order to identify the tone of the texts, several keywords and symbols used by media to frame the subject of the analysis into a certain category, as well as the main directions of the media discourse. The analysis is based on a corpus of 12 journalistic texts that have appeared between May 1991, and August 2010, selected from the online edition on the newspaper The New York Times.

This particular newspaper was chosen because it is considered to be the best news organization in the world, being awarded with 108 Pulitzer Prizes (Los Angeles Times, April 17, 2012).

Media discourse analysis

This chapter of the paper is structured into two parts: the first one presents the analysis of Lance Armstrong's media framing as a classic hero, who is a role-model for the society, whereas the second part describes his downfall and his media portrayal as a modern, fallen hero.

Lance Armstrong – the classic portrayal of the hero:

This part of the analysis focuses on identifying the elements that frame Lance Armstrong as a classic hero who leads an exemplary life and is a role model for the society, until his seventh consecutive victory in The Tour of France.

An athlete with an incredible talent and an inspirational life story, Lance Armstrong seems to be the perfect person to become a media – myth. The cyclist fits the pattern presented by Jack Lule (2001) and described above. According to biography.com, Lance comes from a modest family with a lot of issues: his biological father, whom he does not know, had left them when he was two years old, and his relationship with his stepfather is not good at all. Lance's confrontation takes place on two levels: on a personal level and on a sport level. On a personal level, Lance Armstrong had a tough battle against cancer and he came out victorious, although his chances of survival were 40 percent. In terms of sport, he has proven himself by winning seven consecutive Tour of France titles, which were obtained after he won his fight against cancer.

When retiring from cycling, in 2005, Lance Armstrong is presented as a hero with supernatural powers, who defeated cancer, and who then became the most successful Tour of France cyclist, with seven titles. At that time, it seemed that the archaic, traditional myth of the hero can still be found in the modern society, and Lance was portrayed by media as a example of sacrifice, perseverance and fighting spirit.

In 1991, *The New York Times* (May 13, 1991) writes that, even though Lance is just 19 years old, “he is the star of the amateur cycling nation team of the United States of America”. Two years later, after Armstrong's first participation in *The Tour*, the same newspaper considers him a future champion who resembles Miguel Indurain, another cycling hero. In 1996, the athlete is diagnosed with cancer, and, in an article with a suggestive title – “Each day a triumph”, Lance Armstrong is presented as a “hero because he leads the battle against disease – even if he never came close to winning *The Tour of France*, despite having four attempts, he is a star” (*The New York Times*, November 17, 1996). His first tour victory is presented as a miracle: “in the yellow jersey of the champion, Lance Armstrong finished the last step of his long road to Paris, winning the *Tour de France* 33 months after cancer threatened his life and put his career in danger” (*The New York Times*, July 26, 1999).

The traditional, classic myth of the hero myth reappears in American journalistic texts, where Lance Armstrong becomes the new media – hero. As Mircea Eliade (1978) states in the definition of the myth previously presented in this paper, the cyclist appears to be a supernatural being with sacred power; his behavior is a model for the society, and through the performance from *The Tour of France* and the fight against cancer, he overcomes his mere man condition and falls among the heroes that are not part of the ordinary world. In the articles published by *The New York Times*, on July 23, 2002, Lance Armstrong, now at his fourth victory in the *Tour de France*, is portrayed as a person who “responds modestly to victory, credits his U.S. Postal Service colleagues and praises even his strongest competitors”, “in the late 90s, he defeated cancer, he returned to cycling and now he dominates *The Tour*”. His best presentation is the following: “he falls into the category of the so called super champions, of the cyclists who dominate an era” (*The New York Times*, July 23, 2002).

The fifth win of the *Tour of France* places Lance Armstrong among the cycling elite class, along with Miguel Indurain, the only one who had won five consecutive *Tours of France*. The rider is a mythical hero, not only because he is characterized by social values such as perseverance, humility and team spirit, but also due to his role in establishing social order. In an article entitled “Armstrong’s clear example for all people who are struggling with cancer” and published in *The New York Times* on July 27, 2003, the day before his fifth tour victory, media presents his important role in modern society, as well as his contribution to restoring social order: “Armstrong believes that his experience with cancer led to his ascent to the top. He tested his physical and emotional character, the cornerstone of a champion of the *Tour de France*. The question is: can others benefit from his inspiring achievements? In a practical sense, could other people diagnosed with cancer heal as he did? The answer is absolutely yes. Many people do not realize that Armstrong is not the only one who had a strong comeback after suffering from cancer. After cancer diagnosis, surgery and treatment, many people can return to their previous activities and may be even better at what they do (...) He is not only an exceptional athlete with an inspirational story, he is the evidence of something much most important and extraordinary: cancer is not a death sentence (...) Thanks again, Lance”.

After winning the seventh *Tour of France* and announcing his withdrawal, the newspapers write that: “people in sports doubt that will ever appear a cyclist with such athletic talent and such an inspirational life story (...) Lance is not just an epic athlete. He has an epic life story (...) Lance’s influence goes beyond sport. He is a hero for all cancer survivors in the world” (*The New York Times*, July 22, 2005) and “this decade belonged to Armstrong” (*The New York Times*, July 25, 2005).

Lance Armstrong's important role in the society and in restoring social order can be easily seen. He is an inspirational model that gives people the power to overcome illness and return to success in life. The media portrays him as a mythical hero, victorious not only in the battle with the mountains of the *Tour de France*, but also in the fight against cancer. He is a character with extraordinary powers that managed to overcome the human condition and thus he is placed in the

category of those who go above the ordinary, of those who manage to overcome death. Up to this moment, Lance Armstrong, who perfectly fits the classic pattern of the hero, seems to be the living proof that the traditional hero myth could still be found in media. The rider provides to the society an exemplary model, a behavior that everyone should follow.

The return to The Tour of France – the beginning of the hero's downfall

The aim of the second part of the analysis is to identify the role media played in the hero's downfall, which started when Lance Armstrong decided to return to cycling. The focus is on the downfall of the hero and his transformation into a modern hero.

After Lance announced his withdrawal, media starts the process of celebrity transformation. Armstrong's relations with different actresses become more and more present in the news stories, he is now called "the famous Texas playboy" (The New York Times, June 22, 2008). Cancer researchers state that, after leaving cycling, his involvement in the fight against cancer was not significant (The New York Times, June 22, 2008). In the same story published by The New York Times on June 22, 2008, Lance is now just an American celebrity, with a negative portrayal in mass media.

Lance Armstrong is discredited in the media, and articles about him become more frequent in tabloid newspapers. Moreover, the number of news stories accusing him of doping is increasing. Even though he had been previously accused of doping before retiring in 2005, these accusations were rare and easily discharged.

In September 2008, Lance Armstrong announced his return to cycling and to The Tour of France. His motives were conquering the eighth title, removing all doping allegations around him, and promoting the fight against cancer. However, the doping allegations intensified even more. Information about a dispute between Lance and the French Anti-Drug Agency regarding the violation of anti-doping rules start to appear. "If it turns out that the competitor clearly violated the rules, he could be suspended up to two years" (The New York Times, April 9, 2009). In addition, the same newspaper published the following: "in 2005, the French sports newspaper L'Equipe accused him that his samples contained traces of illegal pills, which help to increase performance".

Once transformed from a classic hero into a celebrity, media now begin discredit Lance Armstrong, presenting him as a modern, in decline hero. His return to cycling, a sport where many important competitors have been accused of doping, not only that fails to clean up the image of the sport, but includes him in the list of cheaters, "the star factor created around Armstrong could not save the sport from the damage caused by the issues related to doping. Lance is caught in the middle of his own doping scandal" (The New York Times, January 1, 2010). After Floyd Landis, one of Lance's former teammates, who was previously discovered and suspended two years from cycling, launches several accusations against Lance, the doping suspicions intensify. In an article entitled "Suspicion is a nemesis that Armstrong can not pedal away from", it is clearly stated that the cyclist has no way to escape from all the doping allegations surrounding him (The New York Times, May 20, 2010).

Lance Armstrong's route during the Tour of France 2010 is characterized by The New York Times as one full of falls, bad luck and failures, where he does not even manage to obtain a stage victory: "the last moments of Tuesday's stage of the Tour of France started as the old days when dominating the race, Lance tried to win. He rose from the saddle and sprinted to the finish, exhausting the legs that helped him to win The Tour for seven times. But this time, unlike many other cases in the past, there was no happy ending for Lance, the most successful in the history of The Tour" (The New York Times, July 20, 2010).

Media presents the two Tours of France from 2009 and 2010 as a total failure for Lance. Furthermore, around him more and more accusations of doping appear around him. The media chooses to portray Lance as a modern hero, whose downfall has already begun. I argue the destiny of this rider may be compared to the fate of the mythological Icarus, who, fascinated by heights, flew too

close to the sun, then fell into the sea and died. Similarly, Lance Armstrong, the hero of the Tour de France, wanted more than he has already obtained and failed. Discredited, with the performances questioned by the media, the cyclist becomes a modern Icarus, and the media that instrumented his fall now plays Helios's role.

According to an article published in *The New York Times* (7 August 2010), the aim of modern heroes, which leads to their abrupt fall is "to rise so far above the rest of humanity, that they become unrecognizable - even by themselves" – basically, a modern reinterpretation of the ancient myth of Icarus. The same article summarizes perfectly Lance Armstrong's downfall as a hero – "he is the most complicated of all tainted heroes, and not just because he strongly denied having taken banned substances to improve performance and infringed the rules of sport. Armstrong really was, and remains, a hero to millions (...) he is the one who defeated a cold and implacable enemy – cancer – to achieve extraordinary success that has inspired millions of people with cancer (...) he has four children and is expecting the fifth (...) his story is mythical. However, he is on the verge of danger of being reduced to a mere cheater in sport".

Findings

The analysis reveals the binary opposition success – failure, which characterizes Lance Armstrong's media portrayal as a modern hero. Media frames him as a classic hero, based on the seven titles won in The Tour of France and his achievements until his 2005 retirement. Media presents him as a hero, a role model for the society, who defeated both cancer and Mont Ventoux. After retiring from cycling, media starts the process of discharging the hero and replacing him with a newly created one. Lance's failure after returning to The Tour, his incapability of winning and the doping accusation are the ones that orchestrate his media downfall.

After analyzing the media discourse regarding Lance Armstrong's evolution, several important moments in his life and career were identified: the fight against cancer, the first title in The Tour, the fourth, fifth and seventh titles, the return to cycling and the final retirement. These moments were highly exploited in the creation and destruction of the media-hero created around Lance. The modern myth of the hero follows, in Lance's case, the known evolution of the modern hero: classic hero, celebrity, and fallen hero.

Media played the most important role in Lance Armstrong's downfall. Even though media had the option of presenting his return to cycling as an inspirational model for young sportsmen, media chose to discredit and to replace him. The society and The Tour of France needed a new hero – that was Alberto Contador, the one who was able to defeat the unbeatable Lance. Thus, media's choice was to remove Lance Armstrong from the mythical area of heroes from our society. After a certain period of time, media replaces old heroes with new ones. Media produces new mythic creations, with a fate similar to the one of the predecessors. Modern societies are in constant need of heroes and thus media can be regarded as a myths' recycling instrument. Heroes are created following a certain pattern, are shared with the society, are discredited and finally replaced.

Conclusion

This paper analyzed Lance Armstrong's media framing as a modern hero created by The Tour of France. After winning seven consecutive titles in the tour, he returns to cycling, but fails to maintain the aura of a supernatural character created around him. Lance Armstrong's failure reveals his human nature, the fact that, in the end, no matter how much he tried, he was not able to overcome his human condition. Media instruments Lance's downfall and presents him as a fallen hero, a modern Icarus of this sport.

The findings presented in this paper reinforce the perspective that media creations have a mythic status. The function of mass media in modern societies is similar to the function of the institutions that produced myths in ancient societies. The myth of the hero is a worldwide spread

archetype, based on the values and ideals of each society. People are in a constant need of having heroes among them, and media plays an important role in satisfying this. Media creates heroic myths according to a pattern; shares them, in order to discharge and replace them after a certain period of time.

Based on the results presented in this paper, a future work could analyze how a powerful total myth, such as The Tour of France, could lead to the creation of new myths. A question that could be addressed in a future is whether The Tour of France, with the help of media, acts as a myth creation laboratory, and what other total myths could be discovered in modern societies. Furthermore, after a certain period of time, media replaces old heroes with new ones.

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THE MEDIA ENVIRONMENT AND ANTI-VACCINATION MOVEMENTS

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Abstract:

The newest media (e.g. the internet) allow the spread of conspiracy theories, entirely or partially fictional information at an unprecedented rate. Anti-vaccination movements across the globe currently use the most modern available communications technology to promote their ideology, to attack the public and to attack systematic solutions that individual governments use as parts of their national vaccination programs. This paper wishes to focus on the issue of freedom of information, yet at the same time point out a rift that exists between factual data and factually incorrect reports that are being spread via the internet, a rift that may be the cause of serious public health issues.

Key Words: Mass media, anti-vaccination movements, communications, internet

The media today

The media environment at the turn of the 20th and 21st century went through drastic changes that significantly affected distribution of information. The classic view of mass media from the perspective of mass media science is that media are products, intended for short-term use, created by formal organizations, for the benefit of a great number of people. The communication involved in mass media is one-way only. (Kunczik, 1995). Three types of traditional media fall under this definition – periodic press, radio and television. Periodic press means, all printed media that is published at least twice annually. The technological carrier is paper. The spectrum of topics covered by the periodic press is virtually limitless. Based on their respective fields of influence, a differentiation can be made between *global titles*, such as international/multinational lifestyle magazines (e.g. magazines such as Elle, Vogue) or international peer reviewed professional journals, *national titles*, which operate across an entire, single country, and *regional (local) titles*, which operate on a smaller scale, (city, region, etc.). The periodic press can also be differentiated according to content, into general/popular titles (daily news, society newspapers, etc.), lifestyle magazines, professional journals (medical, scientific...), economic titles (trend, Hospodárske noviny...), popular science titles (National Geographic, Geo...), the tabloid press, hobby magazines (gardening, hunting & fishing, etc.) and others. Most magazines focus on a narrow target group delineated by age, interests, occupation, education etc. From a psychological point of view, the press is still viewed as the most trustworthy and stable of all media, as, unlike the other two, it is still a tangible thing.

Television is an audio-visual medium that has become the fastest growing branch of the communications industry in the latter half of the 20th century. To this day, it is the most widespread of all classic media. Technologically speaking, television spreads information via television signal, sent from high-powered radio-frequency transmitters to individual TV viewers, who need a television receiver, a specific technological appliance, in order to decipher the signal. Much like the periodic press, television operates on global, national and regional levels. The last 20 years have shown a trend towards specialized international television stations, often broadcast simultaneously in several languages at once. Most television stations appear to the viewer as “free” (as in unpaid), the truth of the matter is, however, that the stations “sell” the viewer to advertisers. An alternative model can be seen in pay television, which carry no advertisements, but are only viewable for a fee. From a psychological point of view, television is the most manipulative of all classic media, as it occupies

two senses at once (sight and hearing). Television does not communicate solely via language, but mostly via visuals, which can be used for subliminal messaging.

The process of sending radio waves into the ether began in the first decades of the 20th century, the inter-war period saw it become the greatest ideological weapon available, and totalitarian regimes in Germany and Russia used radio to a great extent. As radio broadcasting is strictly limited by the language spoken, the medium has not experienced the globalization others have. From a psychological point of view, radio is a shallow medium, fleeting information is interspersed with entertainment, emotions, (music) and often it serves no purpose beyond background noise for the listener. (Kasarda, 2012)

The internet and the media

In contemporary media theory, the internet occupies a special place amongst other media, as it is a multidimensional media; communicating via writing, static and dynamic visuals, and sound. The unclear legislative status of the internet, across the globe, as a platform for communication has led to the creation of standard media websites (i.e. offering materials created by formal organizations, intended for short-term use...), but also websites created by individuals or interest groups with the purpose of presenting opinions (e.g. pseudomedia websites, such as anti-vaccination websites updated on a more or less daily basis with little regard for standard media fact-checking practices). Furthermore, there are websites that are not considered media at all and make no attempt to be viewed as such (reference sites, corporate websites or even pornographic websites), commercial websites (supplementing the standard brick-and-mortar-shop business model, often with added information value), and the very specific communications base_of social networking websites, which merge media information and private communication.

The consumer, however, has a different view of the internet. All the websites located in virtual space that he or she perceives via a screen (computer, mobile phone) represents some manner of wondrous colorful magazine that covers all topics of interest imaginable. To the consumer then, the internet is a media in and of itself, and as the line between professionally managed information, in the form of media websites, and freely available opinions, misleading or untrue information is blurred, the inexperienced, reader oftentimes cannot differentiate between the two.

The H1N1 flu pandemic of 2009 is an interesting example of the problems that emerge when questionable information is publicized, which significantly impacted and affected the course of the pandemic. From the first outbreak in Mexico on, official media information has always been accompanied by internet rumors of an artificially created disease, a plot by big pharmaceutical, the US government and its various intelligence agencies, a field test for biological weapons of mass destruction or other, similar conspiracy theories. With the spread of the disease across the globe accompanied by adequate WHO (and individual countries' public health institutions') activity, involving vaccination research, among, primarily on the internet, the flow of information concerning the vaccination producer's dangerous game to retain profits strengthened. Voices commending on the flu epidemic and the dangers of vaccination became so strong, they in fact managed to enter official non-internet media across the globe and affected the behavior of people with regard to vaccination to a significant degree.

A year later, as the WHO lowered the alert level down from Phase 6, which is the highest level, even in official WHO channels there was talk of the medical measures having been performed acceptably, the communications side of things, however, was clearly the weakest link. Authorities were slower to publish information, much more somber and concise, while alternative sources, such as anti-vaccination activists or conspiracy theorists, relentlessly attacked, challenged information at every turn and presented a manipulative interpretation of facts. To make matters worse, this information, often very apocalyptic in tone, was spread via a modern whispering campaign, conducted on social networking websites. The result of this activity was that a distrust to authority from the side of the public formed, and many refused immunization. Further scaremongering followed and anti-vaccination stances strengthened.

Types of information in mass media

Oftentimes, the work of a journalist is thought of in narrow terms of reporting the news and other serious matters. Looking at the information one can encounter in media, a simple three-way categorization can be made:

1. News information
2. Publicist information
3. Fictional information

News information refers to all reports of events that have happened in the past, are currently happening or are to happen in the near future. Anything that is important, current or somehow exceptional to a greater number of people can become a report. Anything, from natural disasters, political events, the unveiling of a new model of automobile on to the market, the result of a soccer match, a report on a concert that is yet to happen or even, say, the birth of a two-headed kitten, can become a news item. In order for this to happen, this information needs to make the step from real life into the media and take on the form of a news item.

Between the event and the report's final form in a newspaper (or on the internet, television...) stands the journalist; their job is to capture events as veritably as possible. A journalist's work begins long before processing news material, in fact, the very decision to act on a news event is an act of work with information. Much of what happens in the world is only available to our senses via the prism of the media, and much of what happens is not reported about. Reality is rich in information, but the media can only communicate a small fraction of a day's happenings.

Much information does not have the character of a report, but are interesting, perhaps as a problem, or controversial, or, on the other side of the spectrum, they can fulfill a relaxing function.

This information is referred to as publicist information. They are not "hot" news, but require a more in-depth analysis, expert opinions, opinions of people in general. Some information is seasonal and periodically repeats itself in the media. This information is not new in the sense that an event is current, but current within this immediate part of the cycle of life. Further, this information, when processed by journalists, creates publicist journalism, i.e. the part of journalist work that features opinions, help columns and analyses. Anything that can be viewed as a problem that can be construed as something to be solved can become publicist information.

Publicist information can be serious, analytic, educational, but can also serve to distract and relax. Publicist information bleeds over to various genres: interview, report, analysis, and feuilleton.

One of the most characteristic features that separate publicist information and news information is their respective relation to the time in which a reported event has occurred. Most publicist articles, publicist radio or television segments can be shelved for a week and still remain "fresh". A news article published a month behind is worthless.

All media, television most of all, devote part of their production to **fictional information**. This term signifies all artistic and entertainment programs, radio plays, short stories and other artistic genres. As opposed to news reports the information is not the truth; it is not based on facts, events that really occurred. They aren't lies however, there is a difference between fiction and lies. Fictional stories are created with the intent of presenting information "second hand", about the plane of morals, the value system of real life. The contents of a detective story is, of course, fabricated, but the moral message, (crimes are to be solved and punished) is truthful. Fictional information has a legitimate place in media space not merely because of its entertaining quality, but most importantly because it helps create and strengthen value systems. Televised stories tell of basic topological tales, myths typical for their respective cultures. Most European and American film tradition is still closely related to classic Greek drama, which prescribes that a plot based in a moral dilemma is resolved with catharsis, the recognizing of evil, a declaring of winners and losers, or at the very least, moral victors. In summary, fictional stories have information value; they affirm the truthfulness and foster the stability of values.

Opposition to vaccination and the media

While it may seem that, in the last few years, anti-vaccination movements are on the rise, (mostly in the context of the H1N1 pandemic,) the truth is that this is a Slovak perspective. Anti-vaccination sentiment is nothing new to the information market. The first organized anti-vaccination group was formed in the UK in the year 1853 (Wolf, Sharp, 2002). It was known as the Anti-

Vaccination League and it focused its activity on the option to refuse vaccination. It was founded in response to The Vaccination Act of 1853, which made refusal to vaccinate a three-months-old newborn against smallpox punishable by imprisonment. Eventual implementation of similar compulsory vaccination systems in other countries led to the emergence of local movements opposed to them. For instance in the USA, organized groups emerged in the 1870's, following the British model. In that time, communication with the public was conducted mainly in the form of lectures or via books or pamphlets. With the rapid and almost complete eradication of smallpox at the end of the 19th century, the agenda of anti-vaccination activists underwent change. The new, tragically humorous, line of argumentation still remains strong today: the disease doesn't actually exist, the vaccination is fake, none of it was actually ever necessary and neither is it now.

The anti-vaccination movement experienced a steady decline from the turn of the century up to the 1970's. In the 1970's, it experienced a rapid resurgence, sparked by vaccination against diphtheria, tetanus and pertussis. In 1974 a group of authors working at a London hospital, consisting of M. Kulenkampf, J.S. Schwartzman and J. Wilson published a study of 36 children with neurological problems, which, according to their research, were the result of DTP vaccination. The study received widespread media attention, television and printed media carried "shocking" stories, a group organizing protests even formed and later sued the state/government. The outrage was not contained within the British Isles and soon similar groups were formed in other countries. The number of unvaccinated individuals in Britain sharply rose and towards the end of the 1970's caused regional whooping cough outbreaks. At the same time, several independent institutions discovered that the study that was the main pillar of opposition, was conducted incorrectly and that there was no link between the vaccination and neurological problems.

During the 1980's, in the US and in Western Europe, groups of concerned parents and anti-vaccination activists emerged and sought out, or themselves produced, information and studies about cases of permanent effects or inadequate reactions to vaccination. These cases often were brought to court, with the goal of reaching a financial settlement with pharmaceutical companies.

Another strengthening impulse for the anti-vaccination movement was a study published by A. Wakefield in 1998 claiming vaccination against MMR causes autism in children. The study originally appeared in the reputable magazine "The Lancet", however, it was later revealed that the author manipulated the data. In spite of the fact that the study has been proven to be bunk, that the author's medical license was revoked, and that several independent studies concluded that the vaccine does not cause autism, it was exactly this study that led to a widespread activation of the anti-vaccination movement in the 21st century, especially on the internet. (historyofvaccines.org, 2013)

Taking a more detailed look at the history of the anti-vaccination movement and its portrayal in the media, it emerges that media output can always lead to an activation of public opinion. In the infancy of the movement, this meant books and other printed materials (for a certain period of time the British National Anti-Vaccination League even published their own newspaper), in the 1970's up to the 1990's television, looking for controversial topics, and with the advent of the internet, the new, free communications network became the operating area for a loosely-knit group of international anti-vaccination activist groups.

The basis of these groups' arguments is often very similar: they consider the use of vaccines inappropriate, inadequate, the substances used to be unnatural and the human body to be put under undue strain by them. Claims of side effects of pharmaceutical products are embellished for dramatic effect. Correlation and causation are confused. Regardless of evidence, or more precisely lack thereof, medicine taken within a time-frame in which something bad happens is immediately blamed for any shortcoming. A common reference is to the pharmaceutical industry as a political lobby attempting to take over the world via vaccination, accusations of big business, etc. Conspiracy theories form a part of these activities. Another shared characteristic of activist movements is that they focus their communicative efforts on alternative sources of information, unregulated by media groups – according to conspiracy theories, they are already part of the new world order.

Slovak Anti-vaccination Groups

In Slovakia, the anti-vaccination movement emerged at the beginning of the 21st century. Its main communication platform is the internet. By informing about the extreme risks involved in vaccination, by manipulating information and by placing this information into public spaces, they

intend to change the behavior of specific social groups, in this case, mothers of small children, often with success. Opponents of vaccination attack legal measures (problem of legitimacy of political power), the pharmaceutical industry (problem of economic power) and medicine based on science (problem of legitimacy of science). On each of these levels the relation between activist and authority is antagonistic. In their rhetoric, activists use arguments inherent to modern democratic society; freedom of choice, equality of opinions.

The particulars of the activists' arguments are not important, as the majority of them are merely repetition and most were (repeatedly) debunked in various studies. (For instance the lack of a link between vaccination and autism, the “non-existence” of some diseases, “poison” in the vaccines...) Despite this, they continue to be repeated, to link to each other and to long discredited foreign sources, most of which do not even originate in the field of modern medicine.

Opponents of vaccination attempt to build relationships with the media by presenting vaccination as a controversial topic, a radical stance, a shocking, scandalous thing threatening our very lives. Press corps, in the spirit of commercialization and “tabloidizing”, took up these topics about fear of side-effects. Fear is a powerful emotion and is often used in news journalism as a driving force for negative reports.

Conclusion

We are currently experiencing the greatest information revolution in the history of mankind, a revolution that is in the process of deconstructing all previously used communications systems. Not even radio or television made such a dramatic impact on humanity, knowledge and access to information as the internet did. Information has always been power. Up until the 1990's, information was under the control of select groups – the state, intelligence agencies or private media companies. The advent of the internet led to an explosion of information and a release of said information from ownership structures, *democratization* of said information (in practice, all information has become equivalent), but also *de-verification* (data is no longer being fact-checked by institutions). On the internet, one can learn about the relation between moon and sun from both an astrologer's, and an astronomer's point of view. These two pieces of data are, from the user's perspective, („I found it on the web“) equivalent and from the point of view of value they are close to faith. (Is the astrologer's or the astronomer's data correct? – the internet has no opinion on this, only the user's personal system of values decides). The internet mainly offers information that is hard to control, and as such, this information can and often is manipulated, with the intent of creating at least doubt, but optimally a change in recipient behavior.

The government does not limit the freedom of expression of these activists, because they are neither producers nor distributors of medicine, nor are they doctors, and as such not bound by legislature concerning drug advertising. What more, in the current global legislative vacuum regarding internet communication, it is hardly possible to modify or censor information on a website. While the internet provides a plethora of verifiable facts on classical western medicine based on scientific thought, it also offers an even greater amount of data on alternative medicine and quackery, paranoid conspiracy theories and astrological nonsense.

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AN ASSESSMENT OF DIVIDENDS OF DEMOCRACY IN BURUKU LOCAL GOVERNMENT AREA OF BENUE STATE NIGERIA (1999 – 2011)

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Abstract:

Democracy in Nigeria has brought very few gains and these gains have been rendered insignificant by the negative, uncompromising, depressing and devastating state of the nation. Findings show that the dividends of democracy provided by the government for the masses are enjoyed at a low extent. They are also not equitably distributed. The major reason for the non – equitable distribution of dividends of democracy is corruption in governance aside god fatherism, costliness of Nigeria’s democracy, electoral malpractices, ethnicity, religion and externally triggered democracy. It is therefore recommended that corruption, which is the core impediment to our growth and development, has to be tackled aggressively under a willed and purposeful leadership.

Key Words: Dividend, democracy, Nigeria

Introduction

Nigeria’s return to democracy on May 29, 1999 was seen as an end to the torture, suffering of the military era. It was seen as the requirement for the country to develop following the triumph of democracy as system of government at the end of the cold war where democracy became new world political order. The process of democratization in Nigeria can be traced to the Ibrahim Babangida’s political Bureau in 1986 (Omotola,1997).This was a failure because of the annulment of the June 12,1993 presidential election which was rated as the freest and fairest in the annals of electoral history in Nigeria (Izah, 2003). The regime was unable to cope with the crisis that followed this annulment hence the institution of an Interim National Government headed by Chief Ernest Shonekan (Ojo, 1998). This was greeted with mass protest that it will not put things under control. This allowed for the military takeover of power by General Sani Abacha in November, 1993. However, he was not interested in any transition process. There were resistance, resentment, protests from various groups. General Sani Abacha resorted to arrest, detention, extermination and harassment of his opponents. At the demise of late Sani Abacha on June 8, 1998, this brought in General Abdulsalam Abubakar as the Head of State whose regime successfully completed a transition to civilian administration, which ended by handing over power to a democratically elected government with Chief Olusegun Obasanjo as the president on May 29, 1999.

Democracy is defined as “rule by the people”. After the prolonged military rule in Nigeria and the subsequent return to democratic rule in 1999, the Nigerian people hoped for a life much better than during the military rule.

According to Chaj (2008), democratic governments and legitimate systems all over the world concerns center around providing welfare and basic necessities that will make life easier and prepare its citizens for the challenge of nation building. Some countries even though not endowed with natural

resources, have used their initiatives to guarantee that lives of their citizens are at least comfortable and satisfactory.

From the onset of the fourth republic in Nigeria, there have been repetitions via media, government officials, and populace of the slogan “dividends of democracy” The high expectations of African leaders Nigeria inclusive to connote the slogan “dividends of democracy”. The dividend of democracy means the benefits and the advantages of democracy. These include rule of law (supremacy of the law, equality before the law and fundamental human rights), legitimacy of the state, improved standard of living for the majority of the populace, improved atmosphere of peace and stability etc. All these suppose to be prerequisite for nation’s development (Igba, 2012).

Statement of the Problem

Democratization trend is taking shape in many states of Africa in order to produce the expected result of societal transformation. However, this process is dotted with civil war, genocide, poverty, corruption, insecurity among others still exist in many African countries (Fayemi, 2009).

In Nigeria, people’s desire for democracy is with the hope that it will bring about the nation’s development came to reality on May 29, 1999 with the handling over by General Abdulsalam Abubakar to Chief Olusegun Obasanjo as the civilian president of Nigeria. The transition to democracy poses some challenges for the new democratic government (Agbu, 2000; Eyinla, 2000). These challenges include how to nurture the nascent democracy to maturity such that it can no longer be reversed or eroded. Can we really say there is good governance, respect for human rights and empowerment? Is Nigeria really a democratized nation? These questions brought in the concept of dividends of democracy that has earlier been mentioned.

Democracy in Nigeria has brought very few gains and these gains have been rendered insignificant by the negative, uncompromising, depressing and devastating state of the nation. Since the inception of the fourth republic instead of democracy delivering dividends (electricity, infrastructures, education etc.) as promised by the political leaders, there have been high rate of unemployment, increase level of corruption, increased poverty rate, ethno religious crises, industrial strikes, inception of Boko Haram and its destructive activities (bomb blast, killing, shooting etc.), increased fuel price, inflation despite the fact that the country is experiencing its first longer tenure of democracy.

One can imagine whether Nigeria has experienced thirteen years of unbroken civilian. A critical look at it will reflect that it has nothing close to genuine democracy but a woeful failure to improve the living standards of her populace (Omotola, 2007). The standard of living continues to worsen by the day while the social infrastructures and educational system are still on the decline. Nigerian economy has not showed enough signs of recovery, a phenomenon that has been complicated by the haphazard implementation of the privatization exercise, without due recourse to its social, economic and political cost. The atmosphere of instability has given place to no meaningful development.

Recent reports show that despite Nigeria’s plentiful resources and oil wealth, Nigeria is now considered one of the 20 poorest countries in the world, with over 70% of its population classified as poor, with 35% living in absolute poverty. Also reports indicate that 59% women die during or soon after childbirth every year. The second highest in the world after India (Chaj, 2008).

However, only few Nigerians could testify that democratic rule from 1999 – date has direct positive impact on their lives. Among the very few are the politicians themselves, their families and cronies, business moguls and, consultants who have connections with politicians, professionals and academics given appointments to hold public offices and those that get tokens as defenders and promoters of politicians and public office holders. Furthermore, the Nigerian people who don’t have connections with politicians are continuing to live in hardship and uncertain future. Poverty, maternal

deaths, unemployment, insecurity, underpayment, corruption, rigging of elections, lack of electricity, good drinking water and roads etc. seem to be the order of the day.

Therefore, one will begin to wonder if Nigeria is really on the path to democratization which will deliver the promised “dividends of democracy”. With the democratic rule in Nigeria from 1999 to date, will the Nigerian people testify to any meaningful change that has brought about any positive change in their lives? Have they reaped any meaningful dividends of democracy? Is there will at the polls true reflection of their leaders and representation? Are their leaders and representatives performance anything to hail up about? And have they held the trust invested on them sincerely?

This study seeks to address the following questions. What is the perception of people towards dividends of democracy in Nigeria? Why are Nigerians not enjoying dividends of democracy? What are the possible ways by which dividends of democracy can be equitably distributed so that the masses will enjoy them?

Perception of People towards Dividends of Democracy

Dividends can simply be called the gains or profits realized from democracy. It is an obvious fact that military government operates by decrees while in an ideal democratic government, law operates. Rule of law is what is unique to democracy. It includes supremacy of the law, equality before the law and fundamental human rights. It is only in democracy that rule of law can be obtained. Therefore, rule of law can be said to be part of the dividends of democracy.

Many policies, programmes and plans have been termed “dividends of democracy” by politicians and people since the beginning of the fourth republic till date. They include the introduction of new salary scale for civil servants by the Obasanjo led Administration, multi-party system, deregulation of the communication sector that led to the introduction of Global System for Mobile telecommunication (GSM) was introduced and debt relief during the same administration, the seven point agenda of President Umar Yaradua. The passage of the freedom of press bill, the establishment of nine federal universities and the recent action of the federal government to deregulate the downstream sector in this Goodluck Jonathan’s were also seen as “dividends of democracy” (Igba,2012).

According to Omotola (2007) by dividends of democracy we mean the benefit and positive gestures which the new environment of democracy has brought to bear on the state and society. Ideally, it would include rising legitimacy of the state; improved standard of living for the majority of the populace; improved climate of human rights in all its ramification; all culminating in popular empowerment, participation and enhanced atmosphere of peace and stability as a prerequisite for development.

The Pattern of Dividends of Democracy in Nigeria

The pattern of dividends of democracy in this project signifies how dividends of democracy happen or are arranged in Nigeria. Are the promises of the dividends of democracy fulfilled? In the eventuality of being fulfilled, are they equitably distributed? Have they transformed to improvement in the standard of living of the populace and development of the economy?

The so called dividends of democracy are not enjoyed by the masses but by those in corridor of power and their allies. The minority ethnic groups feel left out while the supposedly enjoying majority ethnic groups are fighting over the rotation policy that decides who assumes office. There have been more cases of ethnic religious crises, bomb blast, unemployment, corruption and other social vices even as the country celebrates its first longer tenure of democracy. Electricity, infrastructures, education etc.

That were promised by politicians during campaigns were not enjoyed. Even when the promises are fulfilled after much plea from the masses, they are either substandard and few. Most times people that are in the grassroots are not carried along.

The government actions to wholly or partially privatize public owned sectors e.g. communication, power and downstream sectors from 1999 till date has little or no positive impacts on the nation's economy. According to Omotola (2007)

Nigerian economy has not showed enough signs of recovery, a phenomenon that has been complicated by the haphazard implementation of the privatization exercise, without due recourse to its social, economic and political costs.

The communication sector is dominated by foreign companies who are known to be loyal to their home countries. They did not give space to local companies to be a major player. The only local company that has been able to contend is GLOBACOM. Despite the fact that GSM have brought ease in communication, it is obvious that Nigerians often experience network problem and providers give out substandard services. The major employment opportunities given to Nigerians are selling of recharge cards, open call centres. Up till now, some villages are still not connected to these networks. The power sector that was partially privatized has not changed in its services. The only thing that changed about it was just the change of name from NEPA PLC to PHCN .Some Nigerians even turned PHCN to "Problem Has Changed Name". Inefficient and ineffective power sector in the country has contributed to slow economic growth as many industries have packed up (Igba, 2012).

The 2011 Report of Transparency International rated Nigerian as the second most corrupt countries .Even though the salary of civil servants increases, the country experienced increased inflation because of that. Civil servants though form a large percentage of employed people in Nigeria, can never be compared to the percentage of the unemployed. The inflation led to downward trend in the exchange rate of the naira. When we are talking about increase GDP, this economics statistics cannot be said to be a measure of economic development in a country like Nigeria where there is a wide gap between the rich and the poor (Igba, 2012).

Reasons why Nigerians are not Enjoying Dividends of Democracy

(a) **Externally Triggered Democratization:** According to Welzel (2008), there are four types of democratization. The first one is responsive democratization where the human empowerment path to democracy is responsive to mass pressures for democracy. It is only *responsive democratization* that responds to mass pressures for democracy. The other types of democratization processes that do not respond to mass pressures can be classified as *enlightened democratization, opportunistic democratization and imposed democratization*. In each of these types, the power elites' vested interest in monopolizing power is overcome by reasons other than mass pressures and in each of these types lead to socially detached rather than embedded democracy. The latter of which can only result from mass responsive democratization. Enlightened democratization is a process where one of the reasons why power elites might succumb to democratize is when negative historical experiences have discredited alternative forms of government.

According to Ogunjiya (2010), democracy as it is practiced in Africa today is an imposed one. He said:

It is clear that the form of democracy as it is practiced in Africa today is an imposed one. Most Africa states are forced to democratise in order to be able to access foreign loans and aid. Therefore, the third wave was not a natural wave. Democracy is adopted to suit the desire of foreign donors and advanced capitalist democracies. The problem here is that liberal democracy does not evolve, as it was in the west, with the African societies.

(b) **God fatherism and Electoral Malpractices:** The presence of god fatherism and electoral malpractices in Nigeria has impeded good governance which provides dividends of democracy in Nigeria. The elections in Nigeria (both primary and general elections) are not free from the firm grip of god fathers and electoral malpractices. Most of political office holders (including political appointment) that get to office are either through a god father or electoral malpractices or both. Many aspirants to political office in Nigeria lack the access to resources usually needed to get to office. The

two most popular political godfathers in Nigeria are late Chief Lamidi Adedibu of Oyo State and Chris Uba of Anambra State. Most times, the god fathers dictate to their protégés on how to run the government. Any opposition from the protégée means disaster as was the case of the fall out between Adedibu and former governor of Oyo State, senator Ladoja who was Adedibu protégée (Human Rights watch, 2007).

(c) **Political and Bureaucratic Corruption:** Nigeria democracy is an externally triggered one. Corruption has rendered our democracy ineffective. There is no commitment to the rule of law, that is needed to enforce civic freedom defines democracy, but commitment to their pockets. According to Ogundiya (2010), corruption is an aspect of poor governance and is defined as the abuse of public office for private gain. Nigeria is a nation where corruption thrives. From 1999 to date, Nigeria has been consistently ranked as one of the most corrupt countries in the world (Transparency International, www.transparency.org). According to the World Bank (2006), Nigeria harbours one of the largest numbers of the poor in Africa. There is gross inability of most Nigerians to achieve a certain minimum standard of living. Corruption has led to acute youth unemployment in Nigeria. Various estimates put unemployment rate in the country between 20% and 50%. According to Ogundiya, among graduates of tertiary institution, unemployment rate is put at between 50% and 75%. This has resulted in general insecurity and high crime rate in the Nigerian society (Ogundiya, 2010).

(d) **Inefficient and ineffective Legislature:** The legislative arm of government is expected to provide adequate checks on abuses of power by the executive and recklessness of politicians. Effective legislature contributes to good governance. Ogundiya (2010) in his views stated that a legislative house must not only be capable of making laws for the safety and general well-being of the people, but must also be able to manage funds in order to provide good life for the entire citizenry. The legislative arm has not been able to manage this responsibility and this has denied the people the gains of democratic governance or dividends of democracy. Legislative arm has not been able to promote good governance through equity in the distribution of resources. Also, the judicial arm that supposes to be an indispensable complement to good governance in Nigeria is inefficient and ineffective. Oyeboode (1996) stressed that the Nigerian judiciary is to a large extent subject to the whims and caprices of the executive but has also been excessively politicised. The state of affairs in this country can also be attributed to the corruption of the judiciary.

(e) **Ethnicity and Religion:** Nigeria is a multifaceted society with diverse cultural, ethnic and religious backgrounds. If these diversities have been properly managed, it would have brought in development most especially through tourism and cultural exhibitions. However, the improper management of these diversities has proved detrimental to the country's democracy largely because of unequal distribution of the country's resources (Igba, 2012). According to Karl Marx "religion is the opium of the masses". Poor people turn to religion as a solace and to a common identity "ethnic" to find comfort. Economically, it is the religion and ethnicity that the politicians use to fulfil their selfish desires in Nigeria. According to Toyo (1994), democracy cannot be genuine and flourishing in a country where citizens are grossly unequal in wealth and the poor, who are the majority, are dependent on the wealthy. The poor are marginalized as they are exempted from the dividends of democracy which was their rights. They do not feel any sense of belonging as a Nigerian. Most of Nigerians are loyal to ethnic group and religious group. There is no common solidarity and when you want something done, the question is no more are you a Nigerian? It has now turned to which tribe are you or what religion do you practice?

(f) **High Cost of Nigeria's Democracy:** Nigeria's democracy operates on the principle of federal character with so many portfolios. Servicing their offices has made our democracy the most expensive in the world while the citizens suffer. Also, 70% of the Nigerian budget is for recurrent expenditure while 30% is for capital expenditure. The recent reaction of the federal government to reduce by 25% the salary of its cabinet was explained by the president as a means of cutting down the costs of running government (www.nationalmirroronline.com).

Methodology

Location of the study

This study was conducted in Buruku local government area in Benue State. Its headquarters is Bukuru town. It has an area of 1,246km² and a population of 203,721 as at 2006 census. The local

government is one of the twenty three (23) local governments in Benue State. The major ethnic group in Buruku local government is the Tiv and Christianity is the major religion. Farming is the major occupation of the people in the local governments. The main reason for the choice is premised on the fact that it is one of the local governments where Tiv, one of the popular minority groups in Nigeria but where the largest ethnic group in Benue is domiciled. The choice of the local government is due to time and financial constraints.

The target population for this study consisted of the residents of Buruku local government area in Benue State who are between 18 years and above.

Sampling Procedure

Probability sampling was employed in order to get sample which is representative of the total population. A total of 120 respondents were randomly selected. The population is large, therefore multi – stage cluster sampling technique was adopted to reach the target respondents. The local government has thirteen (13) council wards. From these wards, three (3) wards were randomly chosen. Furthermore, there was identification of household in each of the selected streets. From these identified households in each of the selected streets, eight (8) households were randomly selected as where the target respondents were reached with one (1) respondent per household. This amounted to eight (8) respondents from each of the selected streets and forty (40) respondents from each council wards. All these came up to 120 respondents from the three (3) wards.

Methods of data collection

Data for this study was gotten from both quantitative and qualitative methods. Questionnaire was utilized as instrument for quantitative, while in-depth interview was used for qualitative .The questionnaire focuses on the socio-demographic attributes of respondents, perception of people towards dividends of democracy, nature and pattern of dividends of democracy, reasons why people are not enjoying the dividends of democracy and what needs to be done for masses to enjoy the dividends of democracy. Also, five (5) in-depth interviews were conducted. Key informants include one youth leader, one women leader, two religious leaders and one traditional leader.

Descriptive analysis was carried out on the quantitative data using social science statistical package to obtain the frequency and percentages. Qualitative data was transcribed verbatim to complement the qualitative data.

Findings

Socio-demographics Attributes of Respondents

This section examines sex of respondents, age, marital status, religion and occupation of the respondents.

Table 1: Socio-demographic Attributes of Respondents

Sex	Frequency	Percentage
Male	64	54.2
Female	54	45.8
Total	118	100.0
Age	Frequency	Percentage

18 – 22 years	32	27.1
23 – 27	43	36.4
28 – 32	26	22.0
33 – 37	11	9.3
38years and above	6	5.1
Total	118	100.0
Marital status	Frequency	Percentage
Single	71	60.2
Married	35	29.7
Divorced	5	4.2
Widowed	7	5.9
Total	118	100.0
Religion	Frequency	Percentage
Islam	23	19.5
Christianity	81	68.6
Traditional	14	11.9
Total	118	100.0
Occupation	Frequency	Percentage

Civil servant	19	16.1
Private worker	24	20.3
Student	40	33.9
Farmer	23	19.5
Unemployed	8	6.8
Others	4	3.4
Total	118	100.0

From the above table, 54% of the respondents, which is the majority, are males while 46% are females. As for the age distribution of respondents, about 86% of the respondents are between 18 and 32 years. This implies that majority of the respondents are youths. Majority of the respondents are single. The table also reveal that about 69% of the respondents practice Christianity. This is not surprising because the study area is predominantly Christian. As regards the occupational status of respondents, 36% are civil servant and those who work in the private sector. This is closely followed by students with 33%. This is true bearing in mind that majority of the respondents are single and mostly youth.

Perception of People towards Democracy

This section deals with people's perception on dividends of democracy, awareness of dividends of democracy by respondents and their sources of awareness.

Findings reveal that 93% (110) which is the majority of the respondents are aware of the concept of dividends of democracy .We can say that the concept is not new to people in the study area.

Table 2: Sources of Awareness about Dividends of Democracy by Respondents

Sources of awareness	Frequency	Percentage
Media	32	27.1
Politicians	33	28.0
Religious leaders	7	5.9
All of the above	46	39.0
Total	118	100.0

It was revealed that majority of the respondents 39% said they got the information about the dividends of democracy from the media, politicians and religious leaders. This is followed by 33% of

respondents who got the information from politicians and 32% claimed their source of information is the media. We can therefore conclude that politicians and media houses talk of dividends of democracy more than religious leaders.

Similarly, during the in –depth interviews conducted, all key informants said that though religious leaders talk about dividends of democracy, politicians and media houses are more conversant with dividends of democracy. A youth leader said:

Politicians and media houses are the major sources of awareness about dividends of democracy most especially during election campaigns. Though religious leaders do talk about dividends of, democracy, it is not like that of politicians and media houses.

Similarly, all the key informants opined that dividends of democracy stand for the gains and benefits of democracy. According to them:

When we talk of dividends of democracy, it means what we gain from democracy that cannot be gotten from another system of government, let's say in the military. Example of dividends of democracy is enjoyment of rule of law, where there is respect for fundamental human rights, equality before the law and supremacy of the law. Other things like access to free education, health care facilities are additions.

Patterns of Dividends of Democracy

As regards the dividends of democracy enjoyed by residents, it was found that majority of respondents 39% (46) said that access to basic social amenities such as electricity, safe drinking water and health facilities are enjoyed by the people. This is closely followed by 32% (38) who said that free education is enjoyed by the people in the community; while 5% (6) mentioned equality before the law. This implies that dividends of democracy that are enjoyed in the community are basic social amenities and free education. Similarly, in the in depth interview, all informants agreed that social amenities especially electricity is being enjoyed.

When asked about the extent to which the dividend of democracy is enjoyed, findings show that 56% (66) said the extent is low. Although 335 (39) claimed it was enjoyed to a moderate extent, while only 9% (10) of respondents said it is to a large extents. From the in depth informants a religious leader sums their views as follows:

Though there is provision of electricity and free education. The people's enjoyment is to a low extent. The free education provided is not standard. This reflects in the parents' preference of private school for their children. The electricity provided is not equally enjoyed by all communities in the local government.

On the contrary, one out of the 5 informants, a traditional community is of the view that dividends of democracy are enjoyed to a moderate extent. According to him.

There is provision of basic amenities especially electricity. Our children can go to school on the bill of the government. As to the extent at which these dividends are enjoyed, I will say that it is to a moderate extent.

Perception of people on while Dividend of Democracy was not Enjoyed

Majority of respondents 85% (100) said that dividends of democracy are not equitably distributed, while 15% (18) stated that it was equitably distributed.

Similarly, four of the informants said that dividends of democracy are not equitably distributed. According to them, *the dividends of democracy are not* equitably distributed and that is why the people are not enjoying them. If you do not belong to the ruling party, or the ruling class, you are on your own. You might not even see them with your eyes let alone enjoying them.

As for the reasons why dividends of democracy are not enjoyed, findings reveal that 100% (118) of the respondents agreed that it was due to corruption in governance. This implies that corruption in governance is a major reason why dividends of democracy are not enjoyed by the masses.

From the in depth interview, a youth leader stated that

“The major factor militating against the growth and development of Nigeria as a country is corruption in governance. It is a major factor behind the non equitable distribution of the country’s resources. It is a major reason why the masses are not enjoying the dividends of democracy. All other factors are secondary. Remove corruption in Nigeria, Nigeria’s problem is 99.9% solved.”

Furthermore, other factors stated by respondents why dividends of democracy are not enjoyed include godfatherism 94% (111); costliest of Nigeria’s democracy 86% (100); electoral malpractices 92% (109) ethnicity and religion 90% (106) and externally triggered democracy 85% (100).

The findings correspond with what was gotten from the in depth interview informants. A women leader argued that

“Apart from corruption, other reasons why dividends of democracy are not equitably distributed are ethnicity and religion, god fatherism, and electoral malpractices. It is an obvious fact that getting jobs in Nigeria is not based on your qualifications but on your ethnic group or religion. Elections are violently rigged and that is why we don’t have good leaders.”

Another informant, a religious leader said that:

Nigeria’s democracy is too costly. The cabinet is too large. Imagine having a Minister of Information and still having a Minister of State of Information whereas all the States have their own Commissioners for information. Also, the allowances that are paid to each senator or honourable are too much. Imagine a senator going home with millions of naira monthly. It is too much.”

Conclusion

The dividends of democracy provided by the government for the masses are enjoyed at a low extent. They are also not equitably distributed. The major reason for the non – equitable distribution of dividends of democracy is corruption in governance. Hence, there is a significant relationship between corruption in governance and non- equitable distribution of dividends of democracy. Other reasons for the non-equitable distribution of democracy are godfatherism, costliness of Nigeria’s democracy, electoral malpractices, ethnicity and religion and externally triggered democracy.

Various measures have to be put in place for the dividends of democracy to be equitably distributed. The equal distribution will enable the masses to enjoy the dividends of democracy. In achieving this, government and individuals have role to play.

Recommendations

Government should ensure that the system is free from corruption. There should be sound anti-corruption policies that will be devoid of rhetoric. There should be transparency and accountability in the policies adopted.

There should also be popular participation. People should be carried along in decision making processes without ethnic or religious bias. When every member of the society is carried along irrespective of his/her class, status, religious or ethnic background, there will be development which will deliver dividends of democracy.

Government should ensure that cost of governance is reduced to the barest minimum. Reducing the cost of governance by limiting the size of the National

Assembly and that of the President’s cabinet will make governance more efficient. It will reduce deficit budgeting particularly on personnel and in general on recurrent expenditure.

There should be viable political parties as political parties are the platforms used by politicians to reflect their political ideas and context for elections in a democratic dispensation. Viable, strong political parties are needed as they are the foundation of good democracy. The more viable political parties are, the more the democracy is strengthened.

Individuals too should find a way of contributing positively to the development of the nation’s democratic institution. Individuals should make sure that they vote for the right person. Voting should not be based on religious and or ethnicity. It should be based on personal qualification of the

candidate. When the right person is put in the right post, he/she will do things correctly. Citizens should shun corrupt practices. They should resist giving and taking bribes. They should fulfil their civic responsibilities. They should stand up for their rights.

Corruption, which is the core impediment to our growth and development, has to be tackled aggressively under a willed and purposeful leadership.

Nigerian leaders have to work extra hard to win back the confidence of the Nigerian people that democratic governance is all about service to the people not service to themselves. Real dividends of democracy should be felt by all Nigerians irrespective of tribe, religion, political differences and social status through enabling the atmosphere to be conducive.

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**UMA METÁFORA VISUAL: DO OPACO À TRANSPARÊNCIA -
AMBIENTES PLURAIS NA CULTURA ARTÍSTICA E
ARQUITECTÓNICA CONTEMPORÂNEAS A VISUAL METAPHOR:
FROM OPAQUE TO TRANSPARENCY – PLURAL SURROUND
ENVIRONMENTS IN ARCHITECTURAL AND ARTISTIC
CONTEMPORARY CULTURE**

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Abstract:

The idea of “transparency” crosses epistemological, sociological, cultural and even political areas and it maintains, in contemporaneity, a privileged place for inquire and significance. Through the passage from opaque to transparency, by means of diverse and gradual degrees of translucence, it is possible to symbolise the creative process in contemporary art and architecture and its repercussions for a gnoseological domain.

Interpreting transparency as a mediating and dynamic entity, we intend to research in modes of understanding for both its material (literal) and metaphorical (virtual) ‘use’ in art and architecture. These accomplish, by means of material choices and formal, functional and aesthetic transformations, a framework where it is possible to observe the passage from a crystalline state to an environmental one.

The opacity/transparency duality addresses, through a plurality of meanings along time, the visible/invisible problem – or, in another reading, the one concerning appearance/meaning. Intrinsic question of both artistic and architectural creations and their meaning, transparency assumes a simultaneously dynamic and discrete statute, transcending what emerges from the work, and can be related to virtuality and even dissolution, from the visibility to others domains.

Key Words: Art, Architecture, Transparency, Environmental, Dissolution

Introduction

Uma das aproximações à ideia de interdisciplinaridade é a detecção de que a produção artística e arquitectónica contemporâneas fornece de forma crescente evidências ao uso da transparência. O interesse dessas evidências –patentes quer em obras que a crítica e a história recente catapultaram para um estatuto de magistralidade, quer em obras menos conhecidas, de carácter mais discreto – prende-se com as modalidades de operacionalização semântica inerentes ao seu processo criativo, bem como às significações resultantes. Poderemos dizer, que a constatação de dissoluções no ambiente, por via do uso da transparência, encontra relações com o fenómeno civilizacional da globalização, bem como a constatação de que muitas das áreas em que se estrutura a sociedade convocam expressamente este conceito da visualidade no léxico argumentativo dos seus discursos, conferindo-lhe valor axiológico.

Estrutura e atmosfera

Ao uso da transparência na arquitetura, e nas artes visuais, parece dar-se uma continuidade, sob o signo da modernidade, na sua versão cubista, construtivista e expressionista, a uma experiência que de certa forma teria no domínio da pintura um ensaio propedêutico a estas questões de visibilidade e visualidade: o impressionismo (e o romantismo). Sob a proposta da luz, a que se referem habitualmente os escritos sobre o impressionismo, a investigação da ideia de reversibilidade torna-se aqui empiricamente revolucionária, na descoberta pictórica do sentido dos ambientes; o protagonismo que a interpretação da atmosfera passa a deter, preconiza uma das maiores revoluções no domínio da representação, pelo contraponto que realiza com a ordenação do pensamento simbolizada através da perspectiva. Assim, a ligação subterrânea que se pode realizar entre o Impressionismo e os vários rostos da modernidade do século XX, detém sem dúvida o ensaio para o desmantelamento do espaço entre o sujeito e estrutura do desígnio em representação: extremamente sério, este percurso de subtis variações relata-nos uma exemplar análise ao lugar da reversibilidade, por entre variadas sínteses sob a égide dos *ismos* modernos. Em registo de fundo, toda esta variada abordagem realiza uma profunda *desconstrução* dos avatares académicos da representação. Neste sentido, o lugar da pintura, na sua proposta da representação do mundo através de uma ‘cromosofia’ eclética, trabalhada e sentida na prática e na teoria²⁷⁷, demonstra exemplarmente o grande laboratório onde estas questões se colocariam já: se a análise empírica seria despoletada através do impressionismo, fundamentalmente no domínio da pintura, poderemos entender que dentro do período a que conseqüentemente chamamos de Modernismo dos inícios do século XX, a ideia de *construtivismo* é, no fundo, uma já ideia de *desconstrução*. Desconstrução através da síntese que refaz conceptual e literalmente esta revolucionária consciência para a representação, exemplarmente entendida na arquitetura da época, testemunhando o lugar onde uma ontologia se interroga sob o signo do seu próprio dinamismo e também da sua inércia, por entre o novo compromisso, o da velocidade, com que espaço e tempo se vinculam.

A perspectiva está ligada etimologicamente à transparência: *Perspicere* significa ‘ver através de’. As clássicas demonstrações exemplificam este movimento transitivo: a literalidade do processo da janela de Alberti, bem como a parede de vidro de Leonardo da Vinci, ou ainda a máquina de desenhar de Dürer, são mecanismos ou dispositivos que se prolongam e que fazem pensar em Vincent Van Gogh e no seu ‘perspector’.

Este paradigma de certo modo sobreviveu à crise do espaço figurativo do século XX. Porque se a transparência da tela ou do suporte entendida como ecrã pode ser contrariada pela fragmentação pictural da superfície, desde o divisionismo ao cubismo analítico, passando pelas fotomontagens surrealistas, pela pintura não retiniana duchampiana, passando pelas transparências de Picabia e chegando até à contemporaneidade, as pretensas opacidades realizam no fundo o papel de um revestimento sobre um acontecimento, o da apresentação artística da pintura, onde a sintaxe continua, muitas das vezes, convencional²⁷⁸. Na fotografia, nos dioramas, nas caixas ópticas, nos diapositivos, na ideia de cinema, é a permeabilidade dos suportes à luz que realiza a transparência como possibilidade para a obra; a escultura interessou-se também por esta possibilidade, tanto pelos

²⁷⁷ Cf. GAGE, John, *Colour and Culture – Practice and Meaning, From Antiquity to Abstraction*, London, Thames and Hudson, 1997; e ainda, do mesmo autor: *Art, Science and Symbolism*, London, Thames and Hudson, 1999.

²⁷⁸ Acrescentemos variadíssimos exemplos, tais como: a matriz da janela de Alberti, revista e revisitada em Delaunay; o dinamismo plástico de Boccioni, onde a transparência e a interpenetração de planos se associam; a sedução de Magritte pelas janelas e vidros nos seus processos de *trompe l’oeil* (relembremos ainda Eduardo Luiz, em Portugal); as denúncias de Duchamp sobre a transparência em possibilidade, quer pela sua ausência, em *Fresh Widow*, quer pela transparência enquanto perversidade patente no *Grand Verre*; a pintura de Paul Klee, nas suas sinestésias de ‘polifonias’ cromáticas de estratificação textural; a necessidade surrealista de ‘abrir janelas sobre as maiores paisagens utópicas’, no desejo dos ‘grandes transparentes’, índices do ‘novo mito’, com André Breton, em 1942.

materiais empregues, pela consideração do espaço interno e intermédio (numa abordagem para-arquitectónica como um novo campo da escultura), como pelo efeito das formas virtuais e das sobreposições, como nas experiências por exemplo da Bauhaus, de Naum Gabo, de Moholy-Nagy ou Henry Moore.

O interesse pelo cristal²⁷⁹ e as analogias expressionistas, quer na pintura, quer na arquitectura, testemunham o assumir da dimensão metafórica que envolve a transparência. Acrescente-se que Octávio Paz confere à transparência um ‘valor epistemológico’, a propósito do *Grand Verre* de Marcel Duchamp, obra que considera como um ‘mito da crítica’. Por sua vez, o que se esconde/revela através do signo entrevê-se no desejo da transparência semântica e origina toda a carga estética do sentido na arte, na aporia da criatividade artística e das suas linguagens ou meta-linguagens.

O desopacificar em possibilidade

Desdobram-se a partir do conceito visual de transparência sentidos figurados: é banal a recorrência figurada à noção de transparência em questões de aceção moral e psicológica, por exemplo nas áreas da política, da economia, da ecologia, da justiça, etc.. Sublinha-se nestes usos o sugestivo carácter transitivo do termo, potenciador de conotações positivas.

A complexidade, polivalência e omnipresença da transparência promovem a apropriação metafórica que invade inúmeros domínios. Assim, vemos diferentes campos do conhecimento abordarem a transparência. Na literatura, entre outros, citemos Valdimir Nobokov,²⁸⁰ V. Photiades²⁸¹, Sílvia Plath²⁸²; no campo do ensaio, J. Starobinski²⁸³ sobre Rousseau, A. Hayvaert sobre Musset²⁸⁴, P. Hamon sobre Emile Zola²⁸⁵, M. Beaujour sobre André Breton²⁸⁶. No campo da filosofia e estética, Anca Vasiliu sobre a ideia de diáfano²⁸⁷, Artur Danto²⁸⁸, Christine Buci-Gluksmann²⁸⁹, Octávio Paz²⁹⁰, Gilles Deleuze sobre a ideia de cristal do tempo²⁹¹, bem como a analogia deleuziana para com a ideia de imanência; a sociologia com Gianni Vattimo²⁹²; a oftalmologia, com Y. Pouliquen²⁹³; na história da embriologia, Amor Cherni²⁹⁴; na linguística, na semiótica e na poética, respectivamente G. Genette²⁹⁵, T. Papp e P. Pica²⁹⁶, na teoria da arte, Phillippe Junod²⁹⁷ e Pedro A. H. Paixão²⁹⁸; na

²⁷⁹ Ver MARCHÀN FIZ, Simón, *La Metáfora del Cristal en las Artes y en la Arquitectura*, Madrid, Siruela, 2008.

²⁸⁰ NABOKOV, Vladimir, *Transparent Things* (1972); *Transparências*, trad. portuguesa de Margarida Santiago, Lisboa, Teorema, 1989.

²⁸¹ PHOTIADES, V., *Les Transparents*, Paris, Stock, 1958.

²⁸² PLATH, Sylvia, *The Bell Jar*, San Francisco, Harper&Row, 1971.

²⁸³ STAROBINSKI, Jean, *Jean Jacques Rousseau, La Transparence et l'Obstacle*, Paris, Plon, 1957.

²⁸⁴ HAYVAERT, A., *La Transparence et l'indicible dans l'oeuvre d'Alfred de Musset*, Paris, Klincksieck, 1994.

²⁸⁵ HAMON, P., «Zola romancier de la transparence», *Europe*, avril-mai 1968, n.º 468-469, p.385-391.

²⁸⁶ BEAUJOUR, M., «André Breton ou la Transparence», in BRETON, André, *Arcane 17*, Paris, Union Générale d'Éditions [10/18], 1965, p.161.183.

²⁸⁷ VASILIU, Anca, *Du Diaphane. Image, Milieu, Lumière dans la Pensée Antique et Médiévale*, Paris, Vrin, 1997.

²⁸⁸ DANTO, A., *The Transfiguration of the Common Place*, Cambridge, Harvard University Press 1981; *The Philosophical Disfranchisement of Art* (1986) trad. franc. *L'Assujettissement Philosophique de l'Art*, Paris, Seuil, 1993.

²⁸⁹ BUCI-GLUCKSMANN, Christine, *Estética de lo Efímero*, trad. Santiago E. Espinosa, Madrid, Arena Libros, 2006.

²⁹⁰ PAZ, Octavio, *Deux Transparents: Marcel Duchamp et Claude Lévi-Strauss (1967)*, traduzido do espanhol por Monique Fong Wust et Robert Marrast, Paris, Gallimard, 1990.

²⁹¹ DELEUZE, Gilles, *Cinéma 2, L'Image-Temps*, Paris, Ed. Minit, 1985.

²⁹² VATTIMO, Gianni, *A sociedade transparente*, trad. do italiano de Hossein Shooja e Isabel Santos, Lisboa, Relógio D'Água Editores, 1992.

²⁹³ POULIQUEN, Y., *La Transparence de l'Oeil*, Paris, Odile Jacob, 1992.

²⁹⁴ CHERNI, Amor, *Épistémologie de la transparence: sur l'embryologie de A. Von Haller*, Paris, Vrin, 1998.

²⁹⁵ GENETTE, G., *Mimologiques: voyage en Cratylie*, Paris, Seuil, 1976.

²⁹⁶ PAPP, T. e PICA, P., *Transparence et opacité. Littérature et sciences cognitives, Hommage à Mitsou Ronat*, Paris, Cerf, 1988.

²⁹⁷ JUNOD, Philippe, *Transparence et Opacité. Essai sur les Fondements Théoriques de l'Art Moderne. Pour une Nouvelle lecture de Konrad Fiedler*, (1976), Nîmes, Editions Jacqueline Chambon, 2004.

arquitectura, Colin Rowe e Robert Slutzky²⁹⁹, Toyo Ito³⁰⁰ e Thierry Paquot³⁰¹ entre outros autores, cuja pertinência analógica para com as suas áreas de estudo e intervenção foi sentida a necessidade de fazer convergir a metáfora da transparência.

As consequências que da ideia de transparência se desprendem com mais interesse para a representação são as que se relacionam com a sua vertente metafórica e com o seu sentido de ambivalência. Ao carácter rigoroso e racional da perspectiva pode-se opor a imersão no irracional e no velamento que se instaura com a anamorfose, essa desinência da perspectiva, convocando a subjectividade e o segredo/surpresa na colocação do observador. A aparente característica de univocidade, adstrita à clareza, passa a estar contrariada: e são estas tendências que, ultrapassando e desarticulando o símbolo da univocidade, designam através da transparência sentidos equívocos e promovem mecanismos para a construção de ambiguidades espaciais: cotejemos as intensas experimentações a este respeito levadas a cabo pelas vanguardas construtivistas do século XX, nomeadamente os trabalhos de El Lissitzky e Moholy-Nagy.

Na recrudescência de sentidos que é possível estabelecer, e servindo-nos da perspectiva desenhada por Philippe Junod,³⁰² articulemos ainda dois sentidos orientacionais: a *transparência horizontal* congrega a correspondência entre as artes, integrando o princípio de que por detrás de uma imagem existe um sentido, um conceito, e vice-versa, na contaminação passível de transparecer, e na dinâmica de uma certa correspondência e traductibilidade entre as artes. Podemos situar aqui as sinestésias: a questão dos sons musicais e a sua relação com a cor, campo de experimentação em vários artistas do século XX, encontra aqui exemplos, nomeadamente através do trabalho, entre outros, de Paul Klee e Kandinsky.³⁰³ Por seu turno, as *transparências verticais* podem ser entendidas como sendo de carácter metafísico ou mesmo místico. São as transparências simbólicas do velamento, que, no seu mistério, integram também o erotismo, pendulando entre o que se esconde e o que se revela³⁰⁴, situando no símbolo de formas transparentes significados tais como o macrocosmos escondido no microcosmos, ou até o sentido do tempo. Integram-se aqui também as experiências ocultistas, de notável influência sobre algumas vanguardas, nomeadamente em autores de tendências abstraccionistas como Kupka, Mondrian e Kandinsky, entre outros, e ainda em André Breton, o papa do Surrealismo.³⁰⁵

Consequentemente, das transparências horizontais e verticais, poder-se-á perguntar no fundo ao que pertencerão os objectos transparentes. Várias relações se podem estabelecer: a sua transparência ou translucidez aludem a questões de óptica; mas esta e o significado, no domínio estético, não têm necessariamente de ser coincidentes. Lembremos inclusive diversas interpretações de transparência: Philippe Junod em 1976 entendia metaforicamente a Arte Moderna como a opacidade, enquanto Louis Marin, em 1989, alterava a interpretação, considerando ser a opacidade a

²⁹⁸ PAIXÃO, Pedro A. H., *Desenho. A Transparência dos Signos*, Lisboa, Assírio e Alvim, 2008.

²⁹⁹ ROWE, Colin, SLUTZKY, Robert, «Transparency, Literal and Phenomenal», *Perspecta, Yale Architectural Journal*, 1963, VIII, e 1971, XIII/XIV, trad. *Transparenz*, 1968, reed. Basel (Birkhänuser), Zurich (ETH), 1974 [Le Corbusier Studien I], 1989, e *Transparence réelle et virtuelle*, Les Editions du Demi Cercle, 1992.

³⁰⁰ ITO, Toyo, *Arquitectura de Límites Difusos*, Barcelona, trad. de Moisés Puente, Ed. Gustavo Gili, 2006; *Escritos*, trad. de Maite Shigeko Suzuki, Murcia, Fundación Caja Murcia, 2007.

³⁰¹ PAQUOT, Thierry, «Transparence et architecture», *Transparences*, Paris, les Editions de la Passion, 1999.

³⁰² Cf. JUNOD, Philippe, «Variations sur la transparence», in AAVV, *Lumière, Transparence, Opacité*, s.l., Nouveau Musée National de Monaco, Skira, 2006, p.155.

³⁰³ Ver o excelente catálogo *Analogias Musicales. Kandinsky y sus Contemporáneos*, Madrid, Fundación Caja Madrid, Museo Thyssen-Bornemisza, 2003.

³⁰⁴ Situamos nesta acepção variados exemplos: desde as representações de objectos transparentes nas naturezas mortas barrocas, ao pendor metafísico de pintura (também da naturezas mortas) de Giorgio Morandi, ou às instalações vídeo de Gary Hill, onde o tempo se convoca na transparência do *medium*, na citação das presenças assim representadas. Citemos também, do músico John Cage, a obra 4'33'', composta em 1952: a peça consiste em 4 minutos e 33 segundos de música sem uma nota sequer, sendo essa a sua duração, de silêncio.

³⁰⁵ Ver BRETON, André, *Le Surréalisme et la Peinture*, Paris, Gallimard, 1965.

metáfora da arte quatrocentista³⁰⁶. Por seu turno, Christine Buci-Glucksmann entende a transparência passível de se entender na alteridade do tempo, como a constante reverberativa que assiste à condição do efémero³⁰⁷ e à sua marca na arte.

Com esta última acepção, a da relação da transparência com o efémero, se relacionam as obras de artes tendentes à criação sem nenhuma mediação material, um dos apanágios da arte do século XX. O desaparecimento da obra, da sua condição material no sentido tradicional, encontrou, nos *happenings*, nas instalações e noutras realizações de arte efémera, a sua condição tendente ao desaparecimento material. Desde o *laser*, passando pelo holograma, à arte digital, ao vídeo, todo um conjunto de *media* consubstancia na actualidade uma vertente para a pouca ou inexistente materialidade passível de constatar na arte contemporânea.

A própria Arte Conceptual, como uma espécie de último avatar das ideias (e convoquemos Joseph Kosuth³⁰⁸), ao ser considerada um território onde se torna premente uma preponderância da intenção e da intuição sobre a realização/materialização da obra, onde esta se torna muitas vezes facultativa, corrobora a tendência para o prescindir da materialização.

De certo modo, o sentido da transparência, tem, como na perspectiva, um histórico, e torna-se possível entendê-la “de forma simbólica” no sentido inventado por Panofsky³⁰⁹: da sua consistência material até à sua própria materialidade prescindida, projectada, desmaterializada, constituindo-se forma preponderante e essencial da experiência da contemporaneidade. Da desmaterialização que convoca a dissolução, como uma proposta, em aporia, para a condição das novas dimensões. Intimamente, estas relacionam-se com o questionar do clássico problema da visualidade: território não espacial onde as ausências retêm uma condição de constância e argumentam um início que não começa já do início. Os resquícios implementam como que uma nova dinâmica, em que a acção pode ser a matéria para a obra, estando esta em potência.

Vestígios, resíduos, obra

A transparência como lugar de mediação estabelece um âmbito de relação: promove a existência de dois sentidos, permitindo a conexão entre duas realidades. O seu carácter não é portanto estático, mas dinâmico, oscilando entre duas realidades. A aparência etérea dos efeitos de transparência, real ou simulada, parece sempre questionar a materialidade, integrando maiores ou menores vestígios desta, como resíduo pré-significativo de presenças.

A transparência promove então variadas acepções: a de metáfora é incontornável, pela possibilidade da criação de um novo espaço semântico, que se passa a permitir dilatando os dados iniciais. A acepção de mediação³¹⁰ que a transparência realiza promove também problemas relacionados com a tradução, no espaço do diálogo que se abre entre duas realidades discursivas.

O homem é um ser que vive num meio, o mundo da sua realidade, nela agindo de modo reflexivo, sobre os seus horizontes imediatos. A criação, a necessidade de comunicar diz respeito com a ultrapassagem dos seus impulsos primários de sobrevivência, os quais lhe permitem a interacção com o entorno mediante a atribuição de um sentido; é neste processo que a realidade adquire uma dimensão humana.

³⁰⁶ MARIN, Louis, *Opacité de la Peinture. Essais sur la représentation au Quattrocento*, Paris, Usher, 1989.

³⁰⁷ BUCI-GLUCKSMANN, Christine, *Estética de lo Efímero*, trad. de Santiago E. Espinosa, Madrid, Arena Libros, 2006.

³⁰⁸ Com Kosuth a arte é entendida como ‘proposta artística’: relembremos deste autor a sua ‘obra’ “Uma e Três Plantas”: no centro, um vaso com um cacto; à direita, uma definição da palavra ‘planta’ extraída do verbete de um dicionário e ampliada; à esquerda, uma representação fotográfica em escala natural. Apresentação, registo óptico da presença empírica (fotografia) e designação. A representação desapareceu.

³⁰⁹ Citando JUNOD, Philippe, *op. cit.*, p.155.

³¹⁰ O termo ‘mediação’ tem origem latina: *mediatio*, na origem, significa intervenção divina. Para ligar ou unir realiza-se pela mediação um meio termo ou meio que une o que aparece como oposição, o que aparenta excluir-se. Ou seja, a mediação implica a interposição de um meio ou *medium*. Saliente-se porém que, para além do seu significado literal e imediato ‘do que está entre’, mediação implica congregar, compor, assimilar o múltiplo e o diverso, o que ao mesmo tempo implica o estabelecimento de uma distância.

Num certo sentido, a ideia de mediação realiza a interrupção de um fluxo da natureza, no modo em que constitui um afastamento ao que é apresentado como incontornável; a primeira etapa da relação com a natureza pode ser entendida como a imediatidade da relação entre o homem individual e os objectos do mundo, os objectos dados.

Pelo trabalho o homem ultrapassa a distância entre o mundo objectivo e o subjectivo, fazendo a sua obra, criando o seu mundo.

O entendimento da relação entre o mundo dos vivos e o mundo dos mortos tem desde sempre construído a procura de um lugar de intermediação. A experiência religiosa da heterogeneidade do espaço é uma experiência fundamental; a conexão entre as partes heterogêneas, ou a consciência dessa heterogeneidade, segundo Mircea Eliade, é a relação que o Homem estabelece no reconhecimento de que existe um espaço sagrado e espaços não sagrados. Reconhecimento comparável a uma ‘origem do mundo’, à fundação do mito, ligada a uma experiência religiosa fundamental e anterior a qualquer reflexão sobre as origens do mundo. O entendimento de diferenças qualitativas é para o homem religioso a prova de que o espaço sagrado é a matriz do real, e todo o resto é, por conseguinte, extensão exterior e informe que realiza o entorno. O reconhecimento de que o espaço não é contínuo é o que possibilita a condição para o pensar sobre a constituição do mundo. O sagrado, manifestando-se, origina uma ruptura para com a homogeneidade do mundo ao mesmo tempo que instala e revela a existência de uma realidade absoluta, oposta ao sobrance, ou seja, a enorme extensão do mundo circundante. O sagrado manifesta, assim, a necessidade de o Homem fundamentar ontologicamente o mundo. Estabelecendo um centro inicial, um ponto fixo referencial em tanta extensão infinita

A relação entre as duas instâncias, a sagrada e a profana, é um mecanismo de comunicação entre os dois mundos, e estabelece uma mediação. A necessidade dessa dinâmica relaciona-se com a dialéctica presença-ausência, e estabelece-se pela possibilidade de um elemento dissonante, numa estrutura baseada num princípio binário³¹¹. A comunicação, enquanto produção de sentido, manifesta-se porque, segundo Umberto Eco, o homem não domina o todo, e tem necessidade da comunicação como uma alternativa entre as coisas sabidas e as não sabidas, num movimento entre o finito e o infinito, numa abordagem em acercamento gradativo da realidade.

A consciência deste tipo de instância, como um espaço em *interface* de mediação, é, como já temos referido, pressentido por Platão, no *Timeu*, e é o *chora*, uma espécie de espaço transparente, lugar de receptáculo sensível, colocado por um Demiurgo partindo do mundo das ideias. Esse lugar de receptabilidade sensível participa do inteligível de um modo obscuro mediante um movimento pouco claro e caótico.

Caracteriza-se assim a analogia entre a comunicação e a relação entre os mundos da *hierofania*. A necessidade de um diálogo entre o mundo superior e o terreno, ou entre o Céu e a Terra, está desde sempre ligada ao desenvolvimento da existência humana e à sua necessidade de representação. Neste sentido, a obra humana e, nomeadamente, a arquitectura (independentemente dos seus atributos pragmáticos de protecção e de reelaboração constante do conceito de *habitat*) é entendida como representação. A ideia de templo, bem como, mais genericamente, a de cidade, eram lugares de mediação entre o sagrado e o profano, e implicavam uma localização cuidada, como o estabelecimento do rito ‘etrusco’. No estabelecimento das construções, o *mundus* e o *pomoerium* eram lugares intermediários, de relação, de mediação entre os vários mundos, entre o inteligível e o sensível: assim, o *mundus* seria um poço escavado no centro da povoação que conectava os três

³¹¹ Tal princípio, que baseia a operatividade análoga à lógica dos modelos cibernéticos, converte-se num princípio filosófico, como refere Pedro Burgaleta, citando Umberto ECO em *La Estructura Ausente*, Barcelona, Ed. Lúmen, 1972, p. 433. Cf. BURGALETA MEZO, Pedro, *Residua. El Valor de lo Marginal*, tesis doctoral, Madrid, Escuela Técnica Superior de Arquitectura de Madrid, Departamento de Ideación Gráfica Arquitectónica, 1993, pp. 273-274.

mundos; o *pomoerium*, lugar onde era construída a muralha, relacionava-se com os ritos de passagem entre os mundos, marcando a sagrada ‘terra do nada’.

São inúmeros em todas as culturas os exemplos de lugares de mediação, de que os templos em todas as culturas se manifestam como os mais conhecidos, pela apropriação da cultura cristã. A gradual perda do sentido destes ritos traduz de certo modo, na cultura ocidental, a laicização da sociedade e a implementação do profano, por várias vias, de que foi preponderante a via do racionalismo e suas consequências na modernidade e na contemporaneidade.

Voltando à ideia de *chora*, verificamos que, no *Timeu*, Platão relaciona a criação, obra do Demiurgo, com a condução da ideia de Bem, sendo o bem que se pretende comunicar; as aderências matéricas e sensíveis do mundo criado reflectem também, segundo a interpretação heideggeriana, as cosmogonias platónicas como suporte para com uma ideia de comunicação, na génese da necessidade da linguagem: o ser só é assim alcançável mediante a dimensão da linguagem, estabelecendo-se nesta mediação a relação entre o Homem e o Ser.

A ideia de resíduo³¹² que assiste aos produtos da criação, nomeadamente aos artísticos, diz respeito a um conjunto, a uma trama de elementos que funcionam como portas demonstradoras da entrada num espaço, sendo que «este espaço é precisamente o espaço hermenêutico do *chora*»; neste sentido, toda a obra de arte é uma realidade sobranceira de um processo, e cada obra de arte pode ser entendida como uma tentativa de fechar a fenda, a fissura entre os dois mundos, num exercício de desejo de continuidade. A obra, enquanto resíduo, é sintoma da necessidade de uma reposição face a um início original, em que a comunicação não era necessária porque o Sentido, o sentido original, era inerente a esse mundo.

Mas esta actividade introduz uma componente de reflexividade sobre o próprio agir do Homem, ao introduzir um ‘reconhecimento de si no intuir’, realizando a atribuição de um significado à sua acção, através da mediação simbólica.

É esta atitude, caracteristicamente cultural e simbólica, que realiza a especificidade e universalidade da acção humana face ao que poderia ser considerado do domínio puramente instintivo.

O processo de simbolização, ao negar o imediato, instala na mediação a atribuição de um significado para o mundo, desenhando um patamar para a universalidade. Este processo – procurando realizar uma unidade no mundo - relaciona a necessidade de ultrapassar a separação entre a consciência humana e o que surge como dado imediato no mundo, de uma exterioridade face a essa consciência.

O Homem opõe ao imediato o construído e é este que revela o resultado da mediação. A mediação implica deste modo a procura da compreensão intersubjectiva do lugar que o Homem ocupa no mundo, e tal compreensão integra a interpretação, a transformação e a subversão da realidade dentro da qual o Homem se tem movimentado. Nesta procura da compreensão do lugar do Homem no mundo, há que entender um quadro que ultrapasse a mera objectivação do mundo, numa visão do Homem como ser unicamente racional mas também a ultrapassagem da imagem da pura expressividade do mundo interior. Consequentemente, o processo de mediação projecta e exige a possibilidade de uma reflexividade constante que não deixa de implicar uma certa distância, instalando um espaço intermediário, de porosidade passível de apreender alteridades.

Hermenêutica e transparecimento: o interstício e o espaço diferencial

A necessidade da comunicação instala então um espaço diferencial, característico da investigação epistemológica – em que a arte tem um domínio extremamente significativo. Assim, ao

³¹² Domínio a que se dedica a investigação já referida de Pedro Burgaleta, partindo do inquérito ao valor operativo de elementos residuais sintácticos como chaves hermenêuticas, auscultando uma trama residual que integra todas as operações, podendo ser seguida como um caminho no desvelamento da obra. Cf. BURGALETA MEZO, Pedro, *op. cit.*, pp. 10-12.

carácter residual da arte³¹³, a aporia inscreve na obra uma espécie de ausência. É essa ausência que elabora o símbolo, e este relaciona-se com o território metafísico. Os processos de interpretação de uma obra revelam, através dos tempos, a necessidade de nos colocar face à decifração e à experimentação do Ser.

Neste sentido, os processos interpretativos ligam-se com a possibilidade de colocar o sujeito interpretante frente à experiência do Ser.

Vista deste modo, a obra, além de resíduo, é também ocultação, e instala-se no espaço da diferença. O processo de simbolização, inerente à obra e ao seu processo interpretativo, é a manifestação de um espaço hermenêutico – lugar onde reside o Ser – espaço esse entre os mundos.

Testemunho de uma fissura original da presença, o processo de significar repercute a experiência humana ocidental do Ser. Desta, a actualidade da presença repercute-se enquanto lugar de diferença e de exclusão (que é indissociável da questão da temporalidade, como veremos) no sentido em que a sua manifestação é, também, ao mesmo tempo, enquanto presença, uma falta. Instala-se nesta partilha originária da presença e da ausência, do revelar e do velar, uma acepção a que os gregos clássicos associavam com a ideia da intuição da verdade, como revelação e desvendamento. E é neste processo de inquérito à fissura, como fractura entre a presença e a ausência, que o Homem necessita da filosofia: é através desta fractura que se instala a sua angústia metafísica.

Devido a estar dividida a ideia de presença, a realidade torna-se passível de ser simbolizada. É possível simbolizar, procurando actualizar num processo sin-crónico uma realidade original³¹⁴ que é acedida, ou compreendida, em diacronia³¹⁵. Depreende-se que, devido a o desígnio da presença não ser uno - ou seja, estar dividido e separado - se sente a necessidade de significar e simbolizar. A consciência desta separação instala a necessidade da significação, porque o todo não é abarcável. É porque há um diferimento na origem da presença, que a torna enigma, que surge a necessidade de filosofar³¹⁶. Este diferir da origem instala-se em diversas antagonias: são as oposições entre o ser e a aparência, como relação harmónica entre opostos, ou como relação de opostos, como a da diferença ontológica³¹⁷ entre o ser e o ente.

A consciência e denúncia da fissura do processo simbólico têm sido veladas, de certo modo até ao séc. XIX, no Ocidente. As questões que se lhe prendem no plano artístico e gnoseológico são exemplo. A sua ocultação prende-se com interpretações de âmbito metafísico relativas à verdade, tais como em questões de paradigma, verosimilhança e cópia, entre outras. Não é por acaso que o advento da fotografia, no séc. XIX, vai catapultar estas questões, de vincada reexaminação ao longo do séc. XX.

O processo da linguagem (linguística) detém em si, como problema filológico e filosófico, o lugar onde se alude à representação da fissura original. A invenção da linguagem repercute a necessidade de encontrar o outro pedaço da tésseira. Nesse sentido, a noção de signo emblematiza a dualidade do significante e do significado expressa numa unidade, numa nostalgia (melancolia?) do

³¹³ Ao carácter residual da obra de arte, assiste-se através dos tempos, à consciencialização do seu carácter aporístico: toda a obra de arte é, neste sentido, um experimento e uma aporia. E, simultaneamente profunda sede e instrumento de conhecimento. Ao carácter de aporia acrescenta-se a sobrevivência da ocultação do Ser, característica da cultura judaico-cristã, e ao estatuto da representação conseqüente que detém em si, na tradição ocidental, o carácter de resíduo.

³¹⁴ Cf. TRIAS, Eugénio, «Primer libro: el Símbolo y lo Sagrado» in *La Edad del Espíritu*, Barcelona, DeBolsillo, 2006.

³¹⁵ No Ocidente, a arte foi ao longo dos tempos pensada a partir do subsistente, o Ser ou a Ideia, que desvalorizou o tempo como puro devir. O esquema historicista que Hegel apontava (um tempo da Ideia tornando-se consciente de si mesma mediante as formas de arte, no qual, através das fases simbólica, clássica ou romântica a arte ‘realizaria’ a Ideia, que se torna assim consciente de si mesma) desembocaria na ‘morte da arte’ balançando entre o romantismo reflexivo e a ‘superação do religioso. Estas questões serão potenciadas com a ‘antiarte’ do século XX, sobre as quais, entre outros, Artur DANTO elabora de maneira crítica *Après la fin de l'art*, Paris, Seuil, 1996.

³¹⁶ AGAMBEN, Giorgio, *Estancias. La Palabra y el Fantasma en la Cultura Occidental*, Valencia, Ed. Pré-Textos, 1993, p.229.

³¹⁷ Eugénio Trias defende ser este lugar (no seio da Hermenêutica) o lugar-morada para a Ontologia. Cf. TRIAS, Eugénio, *Lógica del Limite*, Barcelona, Ediciones Destino, s.d.

Uno inicial. A significação procura colmatar a fractura da presença, estabelecendo entre significante e significado relações onde o compromisso é a manifestação, mas também o ocultamento³¹⁸. Ainda que nada afirme, em princípio (e segundo Agamben), que a significação esteja vinculada com o processo de ocultar ou expressar.

A diferença original da presença é separada na evidência de uma convergência expressiva construída entre forma e conteúdo, interno e externo, manifestação e latência³¹⁹.

Mas a perenidade da significação (signo, símbolo, ícone) entre variadas contingências sofre também a alteridade do tempo. A aparência aderente à presença original (que se pretende alcançar e que fez parte da utopia do projecto hegeliano) enferma da contingência do tempo.

O tempo, no seu fluxo de ocasiões e de devires, contamina e mina a metafísica do tempo ocidental, tantas vezes dedicado ao Ser e à Ideia. A alteridade da presença deriva do tempo, da condição do efémero que não mais a eterniza e que lhe instala a variação. O efémero capta do tempo os fluxos mais imperceptíveis. Partindo da consideração de Eugénio Trías sobre o interstício como intervalo ou vão do eixo do repouso (espaço) e do movimento (tempo), é possível entender este interstício como algo entre o ambiente e o mundo³²⁰, e capturar o entendimento para o efémero. De certo modo, é desta exploração do interstício e do recurso ao hibridismo entre espaço e tempo que se manifestam as estéticas da modernidade e as formas de arte. Na relação que pretendemos estabelecer com a ideia de obtenção da transparência, a intersecção do tempo e do espaço promove uma das grandes obsessões do século XX, e o interstício³²¹ que intersecta o espaço-tempo manifesta-se através da imagem que se realiza mediante processos de translucidez, por entre a opacidade e a transparência. Neste contexto, impõe-se a necessidade da revisão do estatuto do olhar e da visão como portas para o processo de translucidez.

A cultura do cristal e da transparência invade a modernidade do século XX. A procura da transparência não é uma ansiedade que tenha nascido na modernidade, mas faz parte dela, numa alegoria que já não é apenas religiosa mas que passa a alegoria política e estética. Se, por um lado, a

³¹⁸ Na perspectiva do simbólico, onde parte do significado está velado, realiza-se porém uma aderência apenas parcial. Tal problema coloca-se com pertinência redobrada no domínio das artes, salientando-se nesse sentido a necessidade pragmática que Hegel estipulou na tentativa de colmatar este resíduo. Nas suas *Lições de Estética* procurou reificar na obra de arte um modelo para a superação do símbolo, onde se salienta a angústia pela aderência total entre as duas instâncias. «O simbólico, no sentido em que o entendemos, cessa com efeito ali onde a livre individualidade, em lugar de representações indeterminadas, gerais, abstractas, constitui a forma e o conteúdo da figuração. Significado e representação sensível, interno e externo, coisa e imagem já não são então distintos uns dos outros e não se apresentam já como um todo, em que a aparência não possui já outra essência nem a essência outra aparência fora de si ou a seu lado.» HEGEL, *Lições de Estética*, cit. por AGAMBEN, G., *op. cit.*, p.230. Nesta obra tratam-se questões sobre o surgimento do lugar poético numa época em que o pensamento europeu despontava reactivamente face a uma cultura racionalista radical. Na procura de um lugar integrador para com o racionalismo e o Homem, o pensamento poético articula-se como um lugar entre o irracional e o racional.

³¹⁹ «Estas forças afloram das regiões mais profundas do latente relacionadas com as leis de construção interna e de formação, onde confluem distintas famílias de forças, que entram em interacção sinérgica, definindo a aura do objecto (...) e a coesão do sistema. (§) O sentir da percepção e as suas implicações vitais e significantes, a nível emocional, apresentam-se como algo que ultrapassa o âmbito estruturalista da *Gestalttheorie*. (§) A latência corresponde também à “invisibilidade secreta”, ao conjunto de relações mais ou menos condensadas e direccionadas: signos, símbolos, expressões, forças e intensidades, que são afinal a presença que se faz sentir de outras realidades intangíveis, invisíveis e indizíveis, cuja abordagem se expressa simbolicamente, se pressente e intui. (§) o latente relaciona-se com a invisibilidade do conteúdo que se vai moldando ou do conteúdo subjacente a uma obra. Como observa Chantal Mailard: “o profundo é o lugar onde os acontecimentos – a vida - tudo o que constitui a superfície, deve ser moldado, deve adquirir a forma dos símbolos e ordenar-se em universos compreensíveis2.(§) a simbolização surge então como uma necessidade de conferir forma perceptível ao invisível, latente e não objectivável». CRUZ PINTO, Jorge, «Latência», *O Espaço-Limite. Produção e Recepção em Arquitectura*, Lisboa, ACD Editores/FA-UTL, 2007, p.120.

³²⁰ Ou entre o *logos* como razão e proporção e o *logos* figurativo-icónico ou significativo. Cf. TRIAS, Eugénio, *op. cit.*, p. 90 e ss.

³²¹ Uma das imagens paradigmáticas da relação da transparência com o intersticial, com a ideia de ‘/’ enquanto lugar de fenda e de interstício, retomando a ideia de Eugénio Trías atrás citada, é a que se realiza mediante o *Grand Verre*, de Marcel Duchamp. A utilização do vidro, proporcionando inúmeras interpretações, realiza aqui uma analogia para com a ideia de ‘/’, podendo esta ser relacionada também com a problemática de *inframince* duchampiana.

transparência cristalina, que tem um dos credos na univocidade e clarividência, fez parte da estética e da concepção da modernidade, é importante conceber que há outra face, e talvez mais profícua, para com a ideia de transparência: ao conjugar tempo e transparência (como no cinema e no vídeo), a fluidez decorrente engendra uma multiplicidade de tempos efémeros, muitas vezes intersticiais, que não dependem somente do poder da visão. Este paradoxo assume-se como um dos resultados da alteração do vínculo entre espaço e presença contemporâneos³²².

Desse modo, a transparência e a cultura do efémero já não se identificam apenas com a clareza de pretensão política³²³, no avatar que habitualmente se convoca; mas realizam a falta e, simultaneamente, a proximidade, pela complexidade que também agenciam.

A captação dos movimentos fluidos, de transições ambíguas e de mudanças quase imperceptíveis, é realizada pelo efémero nas imagens-luz da temporalidade característica da cultura dos fluxos. Constelando a ideia de um mundo transparente, sem limites físicos, o que produz uma nova percepção e consciência do mundo e do nosso entorno.

Conclusion

A cultura do cristal e da transparência invade a modernidade do século XX. A procura da transparência não é uma ansiedade que tenha nascido na modernidade, mas faz parte dela, numa alegoria que já não é apenas religiosa mas que passa a alegoria política e estética. Se, por um lado, a transparência cristalina, que tem um dos credos na univocidade e clarividência, fez parte da estética e da concepção da modernidade, é importante conceber que há outra face, e talvez mais profícua, para com a ideia de transparência: ao conjugar tempo e transparência (como no cinema e no vídeo), a fluidez decorrente engendra uma multiplicidade de tempos efémeros, muitas vezes intersticiais, que não dependem somente do poder da visão. Este paradoxo assume-se como um dos resultados da alteração do vínculo entre espaço e presença contemporâneos³²⁴.

Desse modo, a transparência e a cultura do efémero já não se identificam apenas com a clareza de pretensão política³²⁵, no avatar que habitualmente se convoca; mas realizam a falta e, simultaneamente, a proximidade, pela complexidade que também agenciam.

A captação dos movimentos fluidos, de transições ambíguas e de mudanças quase imperceptíveis, é realizada pelo efémero nas imagens-luz da temporalidade característica da cultura dos fluxos.

³²² «(...) pois trata-se de uma cultura do efémero eterno, na medida em que o tempo se torna “eterno presente” estendendo a todas as coisas o que Benjamin dizia da moda: “a moda é o eterno retorno do novo”. E é sem dúvida aqui que se há que reafirmar fortemente a distinção dos dois efémeros: o efémero melancólico, que revive e reactualiza sem fim o passado e suas marcas, e o efémero-afirmação que integra, aceita e transforma a “fluidez” dos fluxos electrónicos (...) produzir tempo sem reproduzi-lo poderia ser próprio de um efémero assumido, num novo trabalho de imaginação, o do plano de imanência planetário.» BUCI-GLUCKSMANN, Christine, *Estética de lo Efímero*, trad. castelhana de Santiago E. Espinosa, Madrid, Arena Libros, 2006, pp.48-49.

³²³ «Transparência é lema para corporações, governos, universidades e para instituições de todo o tipo e descrições, para a Internet e a maneira como nos conectamos com o mundo. É quase impossível abrir um diário ou revista em que não encontremos uma referência a transparência, geralmente encarada como uma característica positiva, como um objectivo ao qual inquestionavelmente devemos aspirar.» ARCHER, D., *The Transparent State. Architecture and Politics in Postwar Germany*, Nova Iorque, Routledge, 2005, p. 273.

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Constelando a ideia de um mundo transparente, sem limites físicos, o que produz uma nova percepção e consciência do mundo e do nosso entorno.

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LUTHER AND LUTHERANISM: THE P. O. BOX MARTIN LUTHER

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Abstract:

This article explores the idea that social communication performs *coupled* with the consciousness of human beings –but it is not generated by it–, and gives the example of the German reformer Martin Luther. An overlap in the operations of consciousness and of communication – *interpenetration*– is made possible with the person/actor distinction, which actualizes in communication through schemata (the person-schema and the actor-schema), the so called P. O. Box Martin Luther. Luther's positioning in relation to the polemical controversies in which he participated –the Peasants' War (radical Anabaptism), the free will and the sacramental debates–, determined the future course of his Reform, and were decisively oriented by the person-schema. The person/actor schemata also allow the distinction between Luther the person and Lutheranism the doctrine.

Key Words: Theory of Social Systems; Consciousness/Communication Coupling; Language; Schemata; Martin Luther.

1. Introduction.

The theory of social systems provides a novel framework for the study of religions as it considers them strictly as communication re-produced in society *coupled* with the consciousness of human beings (Luhmann 1998, 2007a, 2007b). The example of the German reformer Martin Luther is given in order to show how this works. It has always represented a challenge to explain why Luther and Erasmus of Rotterdam took distance from each other, even though there was a substantial agreement in the communications they both held. Also, it has been difficult to understand Luther's unwillingness to support Swabia's peasants uprising (the radical Anabaptism of Carlstadt and Müntzer), regardless his own frontal criticism of the Roman Church in an institutional and theological ground.

The theory of social systems provides the theoretical and conceptual framework necessary to distinguish Lutheran doctrinal communication from Luther's actions and decisions (and vice versa), without blurring the difference between communication and consciousness, which are both considered non-transparent (operationally closed). Otherwise, it would come out that Luther's actions involved unexpected consequences, or simply that in the plane of declared motives, Luther failed in his intention of reforming the Church from within while keeping it united, in line with the conclusions reached by one of his classical biographers (Febvre 1988: 264ff).

Unexpected consequences or the motives for action are not themselves bad explanations. But there exists a theory which can analyze and provide explanations to complex phenomena such as this one. Now it can be stated: communication performs internal (individual action and its motives) or external (experiences not attributable to intended action) ascriptions, while in this process the individual consciousness only participates coupled with communication as it articulates its thoughts through language.³²⁶

³²⁶ Luhmann (1998: 140ff, 2007b: 258ff). Not even the turn of an intellectual history into a history of mentalities, and further, into a history of ideas (Chartier 1992: 13ff), as the Annales School does, can avoid the Durkheimian notion that society lies in collective representations instead of in actualized communication.

2. Consciousness/Communication Distinction and the Concept of Interpenetration.

As it is already known, the theory of social systems considers that human beings are a part of the environment of social systems but they do not partake in them. Social systems are constituted *exclusively* by communication. Communication, of course, is in need of human beings to actualize communication, as thoughts are in need of a neurophysiological base that would serve them as a platform. What is important here is to note that communication, consciousness and organisms are non-transparent to each other. They are considered by the theory as operationally self-enclosed, *autopoietic* systems. Moreover, “the ordinary structural coupling between systems of consciousness and systems of communications is made possible through language” (Luhmann 2007b: 79).

There is not any continuity between the operations of organisms (reproduction of life), of the psychic (thoughts), and of social systems (communications). One way to explain this is to say that the conscious activity of human beings has performed for millennia without a need for the least understanding about the neurophysiological bases which make it possible. They both work in mutual and idle unawareness of each other’s functioning: “...man is incapable even of observing what goes on within him in respect to physical, chemical and vital processes. His psychic system has no access to life; it depends on itch, pain or any other mechanism to call the attention of the psychic and trigger the operation of another system, the consciousness of the psychic system” (Luhmann 1998: 61).

This same non-transparency is supposed in the functioning of consciousness and communications. The concept of *interpenetration* denotes the fundamental non-transparency between social and psychic systems, regardless the operations of both systems –thoughts and communications– are conveyed through meaning (Luhmann 1998: 77ff). The idea that meaning is a shared habitat for communication and consciousness allows for some kind of overlap between thought and communication sequences –*coupling* that is made possible through language–, precisely what is pointed out by the concept of interpenetration.

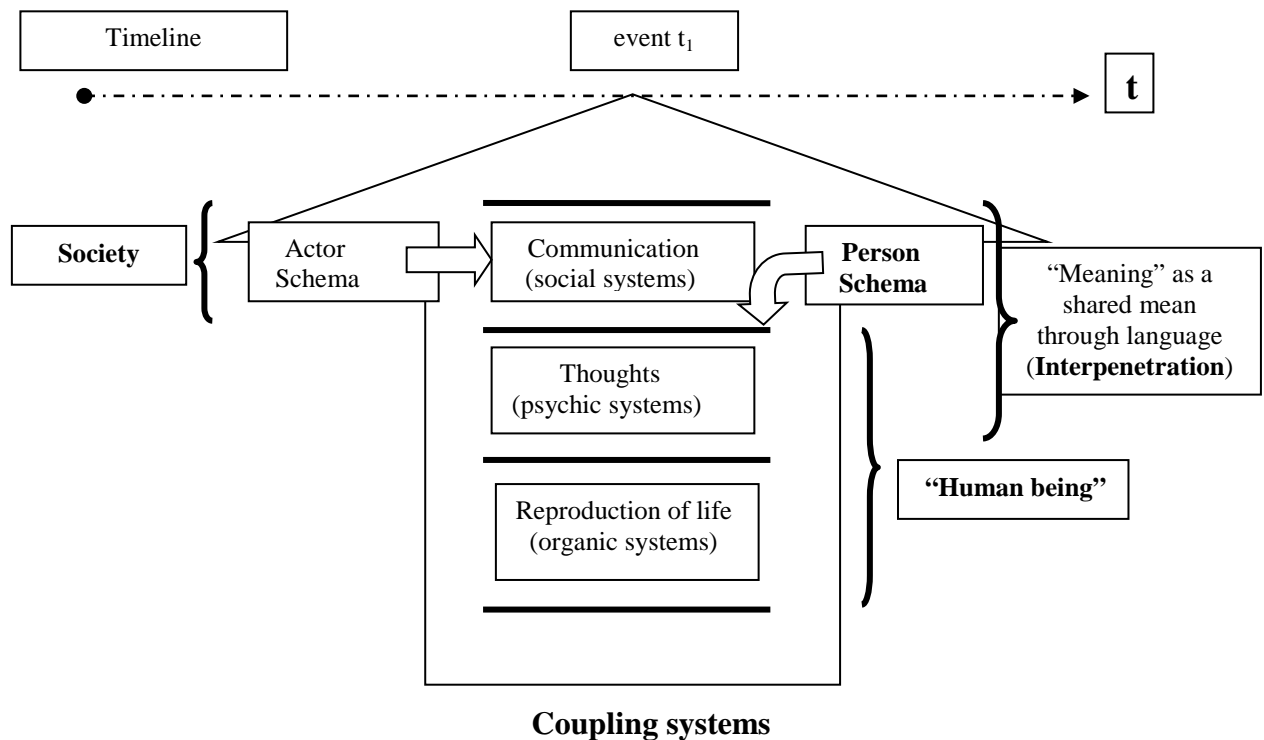
The theory anticipates that bodies or consciousness may interfere with communication, but neither can determine communication. Consciousness does not communicate (nor communication thinks); only communications communicate and only the psychic can think.

As communication follows autopoietic reproduction through iteration, it forms a *sui generis* emergent reality. It is not the human who can communicate, only communication can communicate. In the same manner as communication systems are operationally closed systems which cannot connect to others, likewise, systems of consciousness are operationally closed systems –so are also brains, cells, etc. There is not any communication from consciousness to consciousness that is not socially mediated, in the same way as there is not any communication between the individual and society. The concept of communication is truly understood only by excluding these possibilities, as well as by putting aside the other possibility of conceiving society as a collective spirit. Only consciousness can think, but it cannot think with its own thoughts inside someone else’s consciousness. In both cases we deal with operations within operationally closed systems determined by the structure (Luhmann, 2007b: 76).

Thus, interpenetration is the concept which indicates that every event t_1 in a timeline is the result of a linguistic coupling between communication and consciousness. Communication shares its complexity with consciousness and vice versa by means of language.³²⁷ The concept is graphically shown in Figure 1 (the explanation of the schemata contained in it follows).

³²⁷ In James (2002) one can find an extended and varied study of interpenetration cases between consciousness and religious communications which are classified under the topic: *religious experience*.

Figure 1. The Concept of Interpenetration with Schemata.



3. Schemata: The P. O. Box Martin Luther.

This section is intended to provide an explanation of how communication overlaps the conscious faculty of human beings. The issue is formulated through this question: How interpenetration between consciousness and communication is understood in the case of the beginner of the Protestant Reformation? How can one imagine an overlap between thought and communication sequences in the case of Martin Luther? The answer given in this paper considers the person/actor distinction as fundamental (Japp 2011).

In a very short formulation, the person/actor distinction actualizes in communication through schemata³²⁸ (the person-schema and the actor-schema), which give place to a double operation in communication: by means of the person-schema “communication is reduced to action and consciousness commits to the person” (Japp 2011: 176), while the actor-schema fully guides communication to society and its functional systems.

This theoretical proposal is counter-intuitive because in ordinary language the point of departure assumes the existence of actors in the sense of acting individuals. Individuals have motives and act accordingly... What in everyday *praxis* is considered a compact unit of perception (thought, engagement, understanding, action and even an individual who acts), in the light of the systems sociological theory is broken up precisely into the consciousness/communication difference (Japp 2011: 169).

Nevertheless, one should not forget that even though one speaks about actors, these are but attributions made by communication for the purpose of self-guidance:

³²⁸ “Schemata are simplifications of complex contextual events. A schema discharges communication (and consciousness) of the need of rationalization, and brings about known models, creators of meaning, from not-knowing. In special situations with conflicting meanings (incompatible interpretations of one same fact) or unknown (not-knowing) situations unleash the use of schemata, which link to something already known” (Japp 2011: 174-175). Schemata are supported by classifications and idealizations in order to face the most diverse situations. In this respect see Schützeichel (2012: 75ff), in special chapter 6: Luckmann and the Objectification of Meaning.

From the viewpoint of the systems sociological theory, the actor... is a social address put forward by communication for the purpose of self-guidance. Communication is synthesized in actions by the responsibility of its consequences... One can also say that communication fluency... and linking capacity is acquired by turning into action... One notices that addresses have names that refer to individuals: if communication accounts for them they automatically turn into individuals, they become persons, though they might not be considered by communication as subjects properly speaking, but as “individually attributed expectations of behavior”, that is, as communication units (Japp 2011: 170-171).

This is how a person³²⁹ with a given and a last name (Martin Luther) can be considered as a postal office box in which communication delivers purposes, motivations and achievements (or failures); or maybe it would be proper to say that “‘persons’ are firmly coupled to consciousness, while ‘actors’ are loosely coupled. Or also, that the actors are general standardized addresses, while the persons are individualized addresses with whom one is acquainted” (Japp 2011: 171, fn. 5). The distinction person (with whom consciousness must deal with)/ actor (directed to communication) could then be explained in this fashion:

No one refers to a person with whom one is more or less acquainted and calls him/her an actor. On the contrary, we speak of actors when referring to people who carry out roles, when despite the personal contact they are attributed action capabilities because in principle one can get that knowledge from the person. What is normal is to use the actor concept in order to get rid of communication indeterminacy... Actors assure communication linking capabilities by simplifying a specific attribution of action, which again could be communicated. In a way, actors lead lives as known individuals, but in another way, they also hold a general communication capable of action including that of an address (Japp 2011: 171).

The person/action oscillation makes the person-schema primordial for the consciousness/communication coupling: “As long as the individual remains known as a person, it is the person-schema (not the actor-schema) which makes possible the structural coupling between individual and society” (Japp 2011: 174). The importance of the person-schema lies in that it “comprises a small part of the operations of consciousness as well as a small part of communicative operations –including the one specified by personal expectations. Otherwise, the autonomy of both systems would crumble (one would find either over-socialized persons or an over-personalized communication)” (Japp 2011: 179).

4. The peasants’ rebellions (radical Anabaptism), and the free will and sacramental debates.

Are there examples of ways in which the person-schema operated in Martin Luther? Yes, indeed. One can point to the three issues that were crucial to the development of his Reformation: his separation from the peasants’ rebellions of 1524-25; in relation to these, Luther’s decision to withdraw from the radical Anabaptism of Carlstadt and Müntzer;³³⁰ and finally his argument and breaking-off first with Erasmus, and later on with Zwingli and Oecolampadius.

In relation to the peasants’ rebellions of 1524-25, now is commonly accepted that they represented a point of inflection in Luther’s works between the polemicist and active reformer, and a more conservative reformer focused in organizing the newly non-conformist communication (Lutheranism) (LO, Egido 2001: 15ss; Edwards 2003: 192). How exactly did biography overlap social communication and vice versa? In 1510, when he was returning to Wittenberg from the University of Erfurt, his Alma Mater, Luther faced a peasant revolt that executed the city mayor and burnt the library. It seems that Luther never agreed to this intolerant violence which explained why, years later, at the time of the Peasants’ War, he reacted first with caution, and later decisively opposed violence

³²⁹ One must not mistake human beings of bone and flesh for persons. Persons are but a construct of communication: “Persons are created through the participation of human beings in communication. Persons satisfy the needs of observation in as much as they are attributed with a consistency of opinions and attitudes, behavioral perseverance, self-interests taken into perspective, etc. Persons do not live nor think; persons are constructs of communication for communicational ends” (Luhmann 2010: 117-118).

³³⁰ On the controversial historiography of Thomas Müntzer see Friesen (1974).

when it appeared (Atkinson 1980: 66ff). Various biographical data allow this interplay between the person and the actor schemata in such a way that consciousness and communication remain interspersed (but not transparent to each other).³³¹

The position taken by Luther in relation to the peasants' rebellions took him apart from Carlstadt, his colleague in the University of Wittenberg. Some scholars reduce Carlstadt's radicalism to his capacity to foresee the consequences of Luther's theological statements. Carlstadt was, in such view, an important instigator of the radical Reformation, in particular of Anabaptists:

...it was Carlstadt who translated Luther's assertions into a coherent theological framework, who supplied the theological learning, and who drew out the implications of Luther's pronouncements. One might almost see Carlstadt, therefore, as a forerunner of Melancthon, who performed a similar chore, guided by a vastly different theological propensity, in later years... If Carlstadt's eminent place in the first few years of the Reformation is to be attributed to his ability to discern certain consequences or ramifications of Luther's thought, then the same statement also characterizes his involvement in the rise of the "radical reformation" (Hillerbrand 1966: 395-396).

It seems clear that the Renaissance and the Reformation shared many ideas. The two cultural phenomena were interested in reinforcing Christianity by means of a Church reform: "Both Erasmus and Luther were concerned with restoring Christianity and reforming the church; they differed in their interpretations of the essence of Christianity³³² and the manner of reform" (Kleinhans 1970: 460). Put in other words:

There were many points of contact in both tendencies: the hope for Church reform, interest in literature, opposition to Roman ways, friendly animosity against Scholasticism, priority to the source of Scripture, critical manners, direct and personal spirituality, etc. If only Luther did not fall into the revolutionary path, or if only men and circumstances did not rush him into it, the connection between Humanism and Reformation would have taken another path. Nevertheless, in truth, positions were inflexible and they distanced from each other when Luther clearly expressed his concept of man, of liberty, and when he showed his dogmatism. Acute humanists –Erasmus was one of a kind– sensed that one authority was to be replaced with another one, and –more decisively– that in the Lutheran system there was no place for man in a leading role (LO, Egido 2001: 28-29).³³³

It is worth noting the way in which a conclusion is reached, and, above all, the labels assigned to each side: "Intelligence was impossible between two persons who depart from basically divergent suppositions, as was the moderate Pelagianism³³⁴ of Erasmus and the acute Augustinian Manichaeism³³⁵ of Luther" (LO, Egido 2001: 29). The statement here is that dogmatic communication *per se*, without being totally absent, was not the main factor of the explanation. What separates them,

³³¹ Like being overwhelmed by a lightning storm in the open field which caused him to promise to dedicate his life to God; or else, to explain his aversion to Roman ways, including the Pope himself, the trip he undertook to Rome in 1510. The relevance of the trip is not what he saw in Rome, but what he was entrusted to do as an emissary of the Erfurt and Nuremberg Augustinian houses: he tried to negotiate with Rome to keep the discipline of the houses untouched since they had already been changed. But "the Pontificate was not interested in Reform, but only in politics and war, music and hunt, comedy and carnival" (Atkinson 1980: 68). On his trip to Rome and many other biographical details compare also Febvre (1988).

³³² The point of doctrine where Luther and Erasmus disagreed was the understanding of the free will –praised by Erasmus but unacceptable to Luther's Theology of the Cross.

³³³ "Both agreed [Luther and Erasmus] in their opposition to late Scholasticism, to the great ignorance of clerics and monks, and to the shocking and shameless immorality of the ecclesiastical hierarchy, from the Pope way down the ladder. They were eager to return to the old sources and supported the study of Greek and Hebrew. But as early as in 1517, Luther knew that Erasmus' Humanism and Christian ethics were not the true essence of evangelical and theological Christianity, and that his emphasis in Christ, grace, revelation, sin, redemption, servile will, and all the doctrines that were to resound once again worldwide, would open an insurmountable abyss between the two men" (Atkinson 1980: 97).

³³⁴ Pelagianism denies the original sin and even the need of baptism and grace. Moral principles and the monastic discipline propel man to virtue and allows him enter to perfection which frees him from sin (Mitre 2000: 41).

³³⁵ Manichaeism is a religion that opposes two principles, one of light and goodness (God) to another one of evil and darkness (matter). The antecedents of Manichaeism are the doctrines of Gnosticism (Mitre 2000: 12; Marksches 2002: 37-38). Here, Egido refers to the Augustinian doctrine that opposes the two kingdoms (the earthly kingdom to the kingdom of heaven) explained by Saint Augustine in *The City of God*. One must take into consideration that before becoming a Christian Augustine held Manichaean views.

what makes them different, are the biographical features, the person-schema, consciousness committed to the person, no matter if it is about the libertarian humanistic spirit of the one, or the theological stubbornness of the Augustinian cleric. Something similar could be posed for the Luther/Zwingli argument.³³⁶

As Luther and Erasmus³³⁷ grew apart, the sacramental dispute took shape. Again, to explain the different conceptions of the Supper, scholars take the long-term Christian non-conformist communication.³³⁸ While Luther followed Eutyches (Monophysitism)³³⁹ in regard to the sacramental debate, Zwingli showed Nestorian³⁴⁰ tendencies.

The theology of Luther is here almost Eutyichist in his Christology: in a non-technical language it almost admitted that the divine and the human were interpenetrated; it thought about Christ as present in all parts of the sacrament with his transfigured human body. In a way, Zwingli's Christology is "Nestorian" in this matter; without using technical words we would say that it resisted sharing the idea of the union of two natures in the consecrated elements... It seemed as Luther wanted to intensify the reality of the divine nature in Jesus, the man, who had lowered himself in order to assume our humanity... Zwingli, as Erasmus thought it, stressed the humanity of Jesus (although he did not risk his divinity) (Atkinson 1980: 307ff).³⁴¹

It would be very difficult to delineate here precise borders between Martin Luther, the person and the actor; ultimately one is only able to suggest and uncover some contours... with the help of the theory. According to the specialists, Luther's phobias reached pathological heights. The objects of his phobias were the Jews,³⁴² the Turks, the Pope, and the devil (*LO*, Egido 2001: 53ff). Here one finds an advantage of using a social theory like the one explained in sections 2 and 3: what is considered a feature of personality³⁴³ could as well be considered the interplay of the person-schema (the P. O. Box Martin Luther), which is always guided by the characteristics of sixteenth century European social communications. Besides the accentuated proclivity to superstition common to characters of the time, it could well be assured that Luther's phobias were characteristic of sixteenth century European social communications (the Jews by tradition, the Turks for threatening the supremacy of Christianity, the Papacy for its disrepute and for being questioned by the humanist Renaissance, the demon for obvious reasons). All of them, except the phobia to Papacy, for sure were shared by the Popes themselves... Otherwise, where scholars seem to hit the target is when giving testimony of his mood: "His Saxon character is open to charge in funny remarks and in constant jokes... His theology is based in making

³³⁶ For example, if it is true that Luther accepted the real presence as well as the belief that wine and bread were exactly that, wine and bread (*LO*, Egido 2001: 95), he opposed Zwingli when he asserted thus (that bread and wine were only bread and wine) and called it symbolic presence. See fn. 341.

³³⁷ "Erasmus promoted more than any of his contemporaries the cause of Reformation. He worked hard to revive classical, biblical and patristic studies, and also helped to denounce ecclesiastical abuses, the ignorance and prudishness of friars and the intellectual obscurantism of professors... Erasmus was a man of transition, just like Reuchlin or Staupitz were, but even bigger and more important. Erasmus was John the Baptist of the new movement" (Atkinson 1980: 261).

³³⁸ On non-conformist communication and its importance for the formulation of a Christian dogmatics see Ornelas (2011).

³³⁹ Monophysitism is a doctrine that, even though it does not deny the double nature of the Son –human and divine–, asserts that the human nature in Christ had been absorbed by the divine nature (Mitre 2000: 21).

³⁴⁰ Nestorianism is a doctrine that considers Mary as mother of Christ, but not as mother of God himself (Mitre 2000: 23).

³⁴¹ "Zwingli, with humanist convictions and rigor, was unable to understand the real Eucharistic presence and as he translated 'this is my body' for 'meaning my body', he reduced it to something symbolic. He touched one of Luther's sensitive issues, who had been already warned against the prophet of Zurich. When Zwingli answered back to the *Syngramma* of Wittenberg's circle (1526) with his arrogant *Amica exegesis*, where, besides the title and ambiguous expressions, exposed the Lutheran position as illogical, as well as the violence of Luther's writings, and his servile flattery to the princes, he found a quick response by Luther, in similar tones, in a book with an expressive title: *The Words of Christ 'This is my Body' Remain Firm, Against the Illumined*, which was officially reassured in the *Confession of Christ's Supper*" (*LO*, Egido 2001: 30-31).

³⁴² "One of the most shameful chapters in Christian history is the Christian treatment of Jews. For all his originality in so many areas, Luther was tragically unoriginal in this regard. He inherited a notorious tradition and passed it on with, if anything, increased vitriol" (Edwards 2003: 203).

³⁴³ The "character" attributed to the person and the motives are connected in a way that communicates in a credible manner: "We can say that persons (not human beings!) have a character by which is possible to regulate which motives can be ascribed to in a more or less plausible manner. The historical machine of the social system can change the motives ascribed to persons. The person/motive symbolism provides the social system with a combination of continuity and discontinuity, that is, with the possibility of limited and controlled transformations. And everything happens in a psychic-organic environment which remains inaccessible" (Luhmann 2010: 123).

fun of man who is reduced to a complete wreck, and the enjoyment of finding God in Christ, the cause of happiness, in contrast to the medieval anguish which was his point of departure” (LO, Egido 2001: 59).

Luther’s uncontrollable irascible character seemed to last for a lifetime, and became particularly acute by the end:

A reading of Luther’s polemical corpus does leave the distinct impression, however, that in his later years his anger became more shrill, and less leavened by compassion, humor, or even theological reflection. Moreover, his always pungent language became more coarse and scatological. The targets of his ire become under his pen the vilest of hypocrites, totally wicked and insincere, willing minions of the devil, deserving the most horrible fate (Edwards 2003: 204).

Such remarks do not only refer to Luther’s psychological health, but also to his physico-organic shape, to the point of hypothesizing a Ménière syndrome accompanied by senility (Edwards 2003: 204). One is again faced with the concept of interpenetration and the couplings present in every communicative event: organic/psychic/social.

5. Conclusion.

The theory of social systems allows the difference between Luther the person and Lutheranism the doctrine in account of the oscillating interplay between the person-schema and the actor-schema: the so called P. O. Box Martin Luther. In this way, such theory provides explanations made possible through an overlap in the operations of consciousness and of communication.

Luther’s positioning to the peasants’ rebellion, to Anabaptists and “illuminated” (remarkably Carlstadt, though paradoxically Luther himself can be considered one “illuminated” more), and to Erasmus and Zwingli, were decisively oriented by the person-schema. Luther’s reasons, motives and decisions in these matters (the rigorist view with no concessions of Anabaptists, the free will and the sacramental debates) were strongly determined by the need to make compatible the communications of his immediate social environment –Saxony’s religious and political situation in the beginning of the sixteenth century, and his personal circumstance of being an Augustinian monk from the University of Erfurt recently sheltered in Wittenberg– with highly personalized expectations, *biographical* in kind, so to speak.

Contrary to this, the actor-schema determined the parameters of social communication whose main referent is the millenary tradition of non-conformist Christian communication, indisputably anti-hierarchical and anti-sacramental (one can recall the Christian rigorist tradition of Donatists, Waldenses, Cathars, and the Czech Hussites). This important tradition will be responsible of some principal points of the Lutheran doctrine: rejection to religious authority and its corresponding stress in Scripture, universal priesthood, criticism to indulgences, and extreme distrust of sacraments, considered as external signs of grace.

Thus, in Lutheranism it will be possible to distinguish the *scaling* of a heretical Christian tradition, from the contribution of the *person* to such tradition (justification by faith alone, central point of Luther’s Theology of the Cross). If this point of theory –individual/society coupling– is interpreted in this way, it should be clear enough how far is the theory of considering the conscious faculty of the human being as dispensable to communication, even though it denies at the same time the transparency/homogeneity between the individual and society, between psychic systems and social systems, for the *autopoiesis* of both systems would not stand.

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ITALIANS IN LONDON

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Abstract:

The present research on migration to London is part of a larger project involving other similar investigations dealing with the Americas (specifically Canada and Argentina). The purpose of the overall project is the systematic study of some socio-demographic variables and the most significant factors that have helped shape the evolution of international migration in a settlement today. It also illuminates, in a diachronic development, a possible link between the determinants of European and transoceanic migrations and suggests the likely differences. The results that will be presented in this paper are those of the study of a sample obtained by a non-probability snowball sampling through interviews with 221 Italian immigrants in London. The data retrieval is achieved by administering a pre-structured questionnaire. The survey method was based on the traditional and effective optical gender related to different demographic, social and economic factors in order to find different aspects of Italian regional migration to London. We have seen that gender difference has increasingly become more helpful in modifying the traditional migration profiles of Italian regions.

Key Words: Plato, Gender, London, Migrancy

Introduction

Migratory movements, as old as human history itself, involve all countries of the world³⁴⁴ and represent a true vocation of mankind which has its roots in the most diverse motivations.

The migratory process is such a broad concept as to draw together a whole series of factors which influence the future behaviour of the populations involved. The process triggers a complex mechanism which must take account of the interaction between micro-structure (social origin of the migrants, the various social networks) and macro-structures determined by the historical, political and cultural relationships of the countries affected by the migratory phenomenon. Any approach that is of value in dealing with migrations is unable to encompass all aspects of the question, owing to the lack of a single pillar around which all explicative and interpretative questions of human mobility rotate.

These difficulties remain also for quantitative measurement, with the result that migratory statistics are often incomplete. On an international level, the difficulties are also due to complications in collecting the data and by their quality, given that they are often published by countries that do not use uniform criteria. In addition, account should be taken of the illegal character of much migration.

The purpose here is to outline briefly some of the questions regarding migrations, essentially as an introduction to the present research into emigration to London.³⁴⁵ The particular character of the investigation is in exploring, through a twofold analyses of gender category and region of origin, some socio-demographic dynamics of Italian migrations to London, providing, through empirical elements, a further contribution to the many interpretations which already exist within the

³⁴⁴ IOM Data: International Organization for Migration

³⁴⁵ The study is part of a wider project involving similar investigations dealing with the Americas (specifically Canada and Argentina). The overall objective of the project is the scientific observation, in a systematic way and for comparative ends, of the principle socio-demographic variables and most significant motives that have contributed to the historical evolution of the figure of the migrant in an international settlement.

classification model of migrations. In this context the term gender emphasizes the aspect of social construction, arising above all from female emancipation in our times, in contrast with the simple biological difference.

It is therefore of some interest to make an analysis from the point of view of gender that interprets well the changes which time also brings to migrations.

London was chosen for the study because apart from being a great cosmopolitan metropolis, which sees both the transit and settlement of immigrants from the most varied ethnic backgrounds, it has also become more and more the preferred goal of temporary migrants including students, professional people and highly qualified workers who cyclically undertake the adventure of migration for reasons of study, because of necessity or for pleasure. These are the aspects that suggest an interpretation of contemporary migrations as “circular” processes which are at the centre of the transformations which characterize societies in the modern globalized world.

Thanks to the development of communications and transport, the simplicity of travel today has modified the “geography” of migrations, shrinking “the confines of the world” and causing a growing mobility which has understandably become a defining element of the contemporary world.

The socio-demographic characteristics of the Italian presence in London

Little is known about Italian emigration to Great Britain because it has never been a mass phenomenon comparable to that towards other European countries or to the Americas; nevertheless it is a phenomenon with deep roots.

From the end of the 1970s many young people went to Great Britain in order to study the English language or because they were attracted by a way of life which was felt to be more free and rewarding, as well as being facilitated by the guarantee of being able to find work quickly. The subsequent intensification of economic and commercial relations between the two countries encouraged many business people, managers, technicians and staff in various Italian companies and institutions to settle in Great Britain. Today, approximately half the entire Italian community in Britain resides in London, the city which, in the course of time, became the centre of international finance and trade.

The results presented here come from a study of a sample of 221 Italian emigrants³⁴⁶ in London. The data was gathered through the administration of a pre-structured questionnaire in three different ways:

- The questionnaire was sent by post to persons already known and resident in London who, in turn, forwarded it to their friends and acquaintances;
- Direct interviews by questionnaire³⁴⁷;
- The questionnaire was sent online to various associations³⁴⁸.

Bearing in mind that migrations are diversified by the structural characteristics (age and sex) of the population concerned³⁴⁹, it was decided to emphasize a gender analysis, in relation to age, in order point out the modern homogeneity of the lifestyles of the two sexes, the effects of which have brought a change also in the classical migratory profiles of the Italian regions. The entire structure of the processes of mobility has always been closely linked to the economic and social conditions of the populations involved, so much so that the concept of migrant was assimilated with young male of working age.

³⁴⁶ The sample of 221 Italian emigrants, was obtained with by non-probability snowball sampling. Applying the Bayesian theory of probabilities, the retrospective precision of the confidence interval, for a probabilistic significance $\alpha=0.05$, is around 7%.

³⁴⁷ The interviews were carried out in August 2010 by Dr. P. Ferrara.

³⁴⁸ Italians in London, Italians United, Italian Nights, Patronato A.C.L.I., Patronato INAS-CISL, Patronato INCA-CGIL, Patronato ITAL-UIL (UIM).

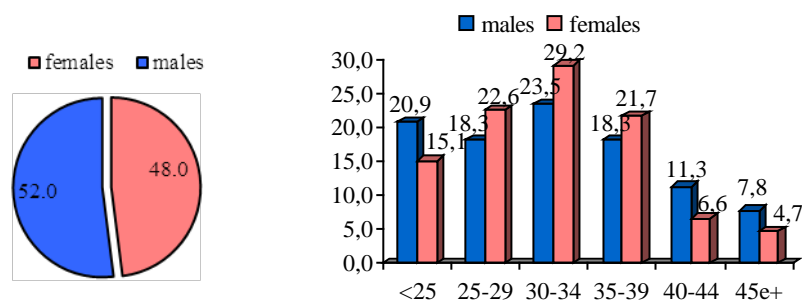
³⁴⁹ Cf. Bonaguidi (1985).

Female emigration has always been secondary to the mobility of men. Women were traditionally characterized by their bond with their homeland, their home, and their family³⁵⁰, and through marriage they acquired a new social status which allowed them the only “migration” possible, that of moving from their parents home their marital home.

Setting aside an examination of the experience of female mobility over the centuries, we focus our attention on the coming to awareness of women as workers which represented a true “milestone” in the emancipation of women, such as to result in the two sexes having very similar lifestyles. Moreover, in advanced industrial societies the greater participation of women in the labour market, understood as a career to be pursued for status and income capacity, the increased number of divorces (with the result that female work is often the primary source of income), the decline of the birth rate and the greater availability of education have created motivations so strong as to attract women to move elsewhere. Consequently, there has been a decisive influence on all social phenomena; and in the particular case of emigration, interesting aspects emerged in this study.

The sample analysed was formed by 115 males (52%) and 106 females (48%) with an average age of 31 and 32 respectively (cfr. Fig. 1).

Figure 1. Percentage distribution of respondents by age and sex

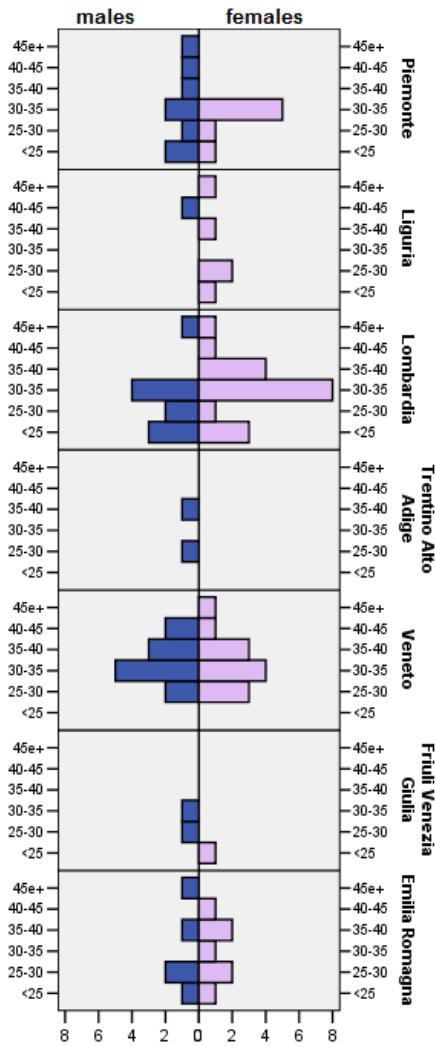


The age pyramids of the individual regions (Fig. 2) demonstrate how the migratory phenomenon significantly affects both sexes between the ages of 25 and 35. It is also noted that a significant number of men also emigrate before the age of 25. Of particular interest is the first result obtained, which in some regions shows a greater propensity among women to move regardless of the great geographical areas. A possible interpretation of this is that territorial asymmetries seem to depend on present day trends dictated by ever more homogeneous models of life between men and women, rather than on historical sedimentation linked to the cultural traditions of the northern and southern regions of the whole country.

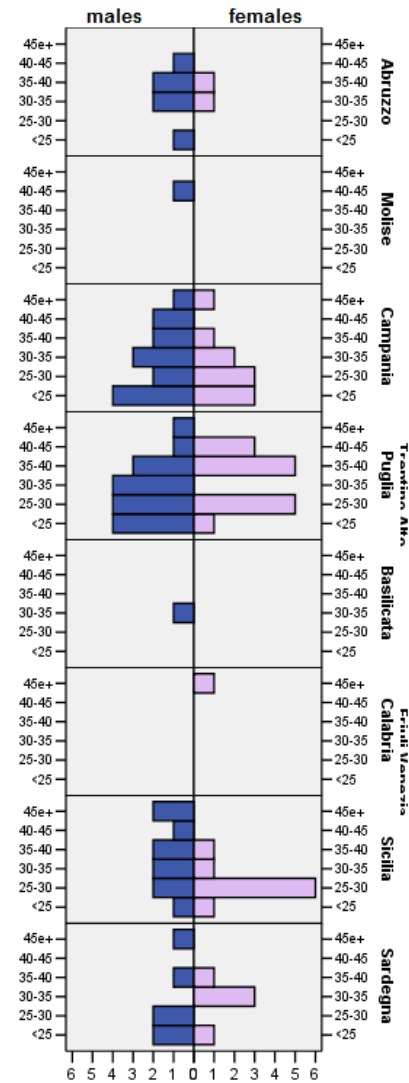
³⁵⁰ History is full of examples: one that serves for all is the classical myth of Penelope who incarnates the model of family loyalty.

Figure 2. Age pyramids of the ages of the migrants interviewed according to geographical area/region

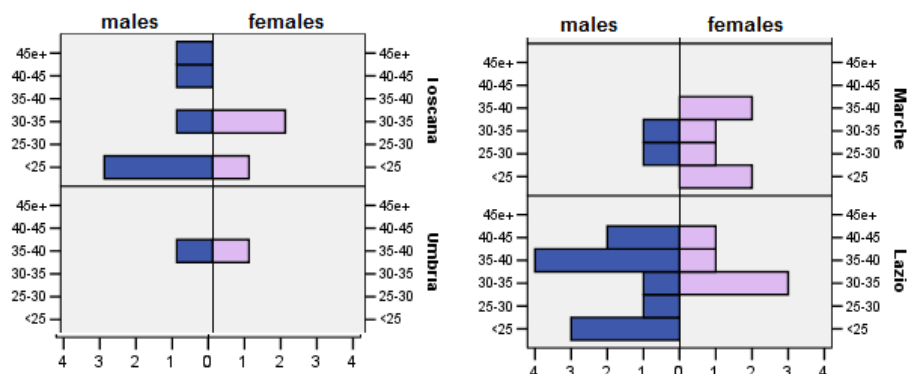
NORTHERN ITALY



SOUTHERN ITALY AND THE ISLANDS



CENTRAL ITALY



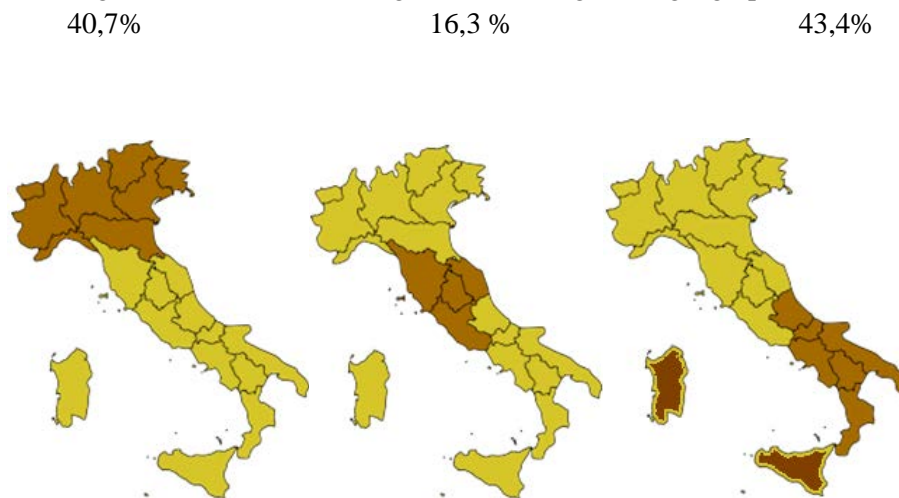
The analysis of the migratory profile according to sex in the corresponding regional behaviour (cfr. Tab. 1) underlines the result, which we have already noted, that the propensity to leave one's homeland is no longer a particular characteristic of men. Indeed, in some regions more women move than men. In the case of Lombardy, in particular, it is curious to note that the number of women who emigrate, in percentage terms, is exactly double that of men. The greatest number of migrants interviewed come from Puglia (14%) followed both by industrialized regions (Lombardy, Piedmont) and by traditionally less developed central and southern regions. Without entering into a complex analysis, the level of emigration does not appear to be determined only by the different role that the regions have in the economic and social life of the country, but reflects a range of situations that are so diversified as to equate regions that are otherwise different from each other.

Table 1. Percentage distribution based on place of origin and sex

Place of origin	Males	Females	Total
Puglia	14,8	13,2	14,0
Lombardy	8,7	17,0	12,7
Campania	12,2	9,4	10,9
Veneto	10,4	11,3	10,9
Sicily	8,7	8,5	8,6
Lazio	9,6	4,7	7,2
Piedmont	7,0	6,6	6,8
Emilia Romagna	4,3	6,6	5,4
Sardinia	5,2	4,7	5,0
Tuscany	5,2	2,8	4,1
Marche	1,7	5,8	3,5
Abruzzo	5,2	1,9	3,5
Liguria	0,9	4,8	2,7
Friuli Venezia Giulia	1,7	0,9	1,4
Umbria	0,9	0,9	0,9
Trentino Alto Adige	1,7	-	0,9
Molise	0,9	-	0,5
Basilicata	0,9	-	0,5
Calabria	-	0,9	0,5
Total	100,0	100,0	100,0

However, the so-called “culture of migrations” is not to be underestimated (Fawcett, 1989), because the more the incidence of emigration grows in a specific collective group, the more cultural evaluations and perceptions are modified and stimulate an increased probability of emigration. This might provide a useful contribution to the interpretation of data about the individual regions, in that the limited mobility found in traditionally little developed regions (Basilicata and Calabria) and in regions characterized by development and productivity (Liguria, Trentino-AltoAdige) could also be read in terms of conservative trends, that is as strong social and family roots which tend to increase the opportunity cost of migration. There remains, in any case, a marked disparity between the great geographical areas. (Fig. 3).

Figure 3. Percentage distribution of the emigrants according to the geographical macroarea of origin



The observation of the variables shown in Tab.2 reveals that most of the interviewees are unmarried and have a high educational level; in particular the figure for tertiary education of single women graduates (72.9%) confirms the trend of an overall increase of female education with significant increases in the number who have university degrees (Pisati 2000, Blossfeld 1993, ISTAT 2010).

Trough the data available, when the analysis is conducted according to sex, age and academic qualification by geographical macro-area of origin³⁵¹, it emerges for the whole country that there is, in percentage terms, a majority of graduates, above all in the age ranges 25-29 and 30-34.

More specifically, the regional difference is seen in the examination of the age range 30-34 since for both sexes the percentage values are higher in central and southern Italy. In addition, significant percentages were obtained for diploma holders in the < 25 range. These values are probably determined by those who declared themselves to be students.

³⁵¹ As already explained in the introduction, I wanted to highlight an investigation which stressed territorial differences.

Table 2. Distribution of the interviewees according to academic qualifications, sex and marital status. Absolute and percentage values according to academic qualifications.

Academic qualification	Sex	Marital status							Total
		married	unmarried	Widower/ widow	separated	divorced	cohabiting		
Degree	M	A.v.	15	39	-	-	-	-	54
		%	27,8	72,2	-	-	-	-	100,0
	F	A.v.	14	51	1	-	3	1	70
		%	20,0	72,9	1,4	-	4,3	1,4	100,0
	Total	A.v.	29	90	1	-	3	1	124
		%	23,4	72,6	0,8	-	2,4	0,8	100,0
High School Diploma	M	A.v.	8	35	-	-	2	-	45
		%	17,8	77,8	-	-	4,4	-	100,0
	F	A.v.	8	21	-	-	1	1	31
		%	25,8	67,8	-	-	3,2	3,2	100,0
	Total	A.v.	16	56	-	-	3	1	76
		%	21,1	73,7	-	-	3,9	1,3	100,0
Middle School Diploma	M	A.v.	3	10	-	-	1	-	14
		%	21,4	71,5	-	-	7,1	-	100,0
	F	A.v.	1	2	-	1	-	-	4
		%	25,0	50,0	-	25,0	-	-	100,0
	Total	A.v.	4	12	-	1	1	-	18
		%	22,1	66,7	-	5,6	5,6	-	100,0
Elementary School Certificate	M	A.v.	2	-	-	-	-	-	2
		%	100,0	-	-	-	-	-	100,0
	F	A.v.	1	-	-	-	-	-	1
		%	100,0	-	-	-	-	-	100,0
	Total	A.v.	3	-	-	-	-	-	3
		%	100,0	-	-	-	-	-	100,0

%	100,0	-	-	-	-	-	-	100,0
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The data represented in graphic form in Fig. 4 show that a distinctive characteristic of the migrant population interviewed is that the greatest proportion with a high academic qualification (university degree) are the women of the South. In effect, as a result of non-traditional educational experience, fewer and fewer women suffer from gender stereotypes today.

In order to verify whether there is a link between academic qualification and gender, Cramer's V index was applied³⁵². Its application did show that a link exists, though it is not an excessively marked one (the value of the index is, in fact, V=0.21). There is, therefore, a positive correlation between gender and academic qualification among the migrants interviewed.

It is argued in a number of studies that for women education represents "a valid mode of social mobility" (Schizzerotto 2002), confirming the desire for personal affirmation. Male educational models which wanted women to be "well mannered but not educated" for a role in the family that was subordinate to the man in all intellectual activities³⁵³ are now long forgotten, proof of the how the migratory model changes in time. In reality, the perspective of analysis adopted suggests that more and more the life choices of both men and women are interconnected and interdependent, and involve the desire not to renounce a life that is as rewarding as possible from every point of view both in the private and public spheres.

Key academic D.: Degree qualification:

H.S.D.: High School Diploma

M.S.D.: Middle School Diploma

E.S.C.: Elementary School Certificate

Figure 4. Percentage distribution of interviewees according to academic qualification and sex, by geographical origins

9 Pearson's χ^2 index measures the association of characters in a politomic $m \times p$ (m line by p column)

$$\chi^2 = \sum_{i=1}^m \sum_{j=1}^p \frac{(n_{ij} - n_{ij}^*)^2}{n_{ij}^*},$$
 where the ratio $n_{ij}^* = \frac{n_i n_j}{n}$ represents the expected frequency in the cell of line i and column j in the hypothesis of independence.

It will be $0 \leq \chi^2 \leq \chi^2_{max}$, where $\chi^2_{max} = n[\min(m,p) - 1]$.

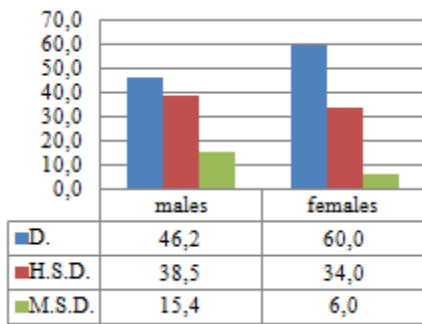
As can be seen from the formula, the maximum value of the index χ^2 depends on the number/ in the sample. To obtain a standardized index (reduced to the interval [0,1]) Cramer's index can be used.:

$$V = \sqrt{\frac{\chi^2}{\chi^2_{max}}}, \quad 0 \leq V \leq 1;$$

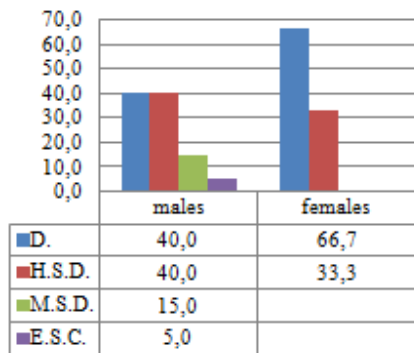
V=0 when there is no association and V=1 in the case of maximum association.

10 The words written by Plato thousands of years ago seem more relevant than ever: «... there is no special faculty of administration in a state which a woman has because she is a woman, or which a man has by virtue of his sex, but the gifts of nature are alike diffused in both; all the pursuits of men are the pursuits of women also» (Plato, The Republic).

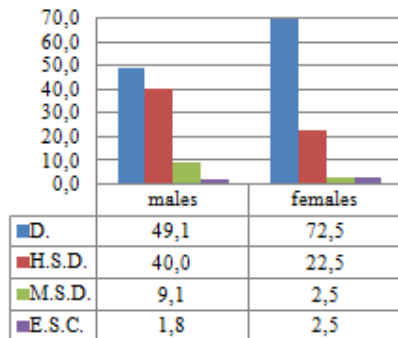
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Length of stay and reasons for emigrating to London

Length of stay is an illuminating point of observation that confirms the importance of the women's academic qualifications. In fact, a greater number of unmarried women who have resided in London for only a few years. Cramer's V Index also suggests a slight but interesting link between length of stay and marital status ($V=0.268$). In effect, most of the married and divorced have resided in London for more than 6 years, while the majority of unmarried males and females have resided there for less than 3 years. The picture outlined above may be further explained by observing the interviewees' lengths of stay in London in relation to their academic qualifications and geographical origins. The graphical representation of the data in Figs. 5 and 6 clearly reveals a greater percentage of women graduates who have only been in London for a few years and who come from all the large geographical areas, above all southern and central Italy.

Another observation deserving of mention concerns the reasons that drove the interviewees to emigrate to London. The questions linked to the opportunity of finding work registered the highest values, with considerably higher numbers among those from the south of Italy.

But everything seems to be defined by the general context in which each person finds himself or herself. It is not by chance that in the North of Italy where there are greater opportunities of work, the interviewees gave less importance to economic dissatisfaction and opportunities of work and favoured the “desire for change” in terms, very probably, of quality of life. The opposite is the case for the South where there is a predominance of motivations related to the opportunities of work. In effect, a little over half of them already had a job before leaving compared to Central and Northern Italy where only a quarter did not have work.

There is no doubt that in today’s world mobility “is becoming more and more an element of real democracy” (Golini, 2000) by means of which all can be given the opportunity to exploit their own potentialities. In practical terms this may mean performing humble work which is simply a means to attain one’s goals. Certainly, the interviewees declared that they never lose sight of their future plans for a more satisfying job suitable for the academic qualifications they possess. Undoubtedly, the motivations which drive them to seek work abroad may be determined by the internal conditions in their country of origin, not only the shortage of jobs, but also the lack of rewarding prospects in terms of both economic and social status. While the incentive to “escape” from the place where one was born or resides may also be to travel for pleasure, the results obtained here indicate that it is usually determined by necessity based on economic calculations.

Figure 5. Percentage distribution of interviewees according to length of stay, sex and academic qualification.

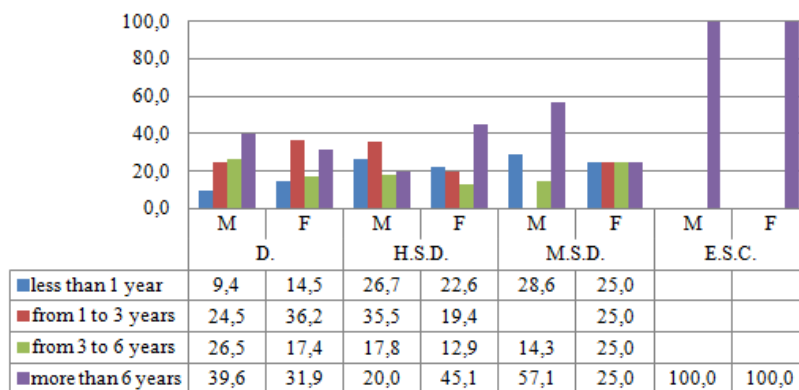
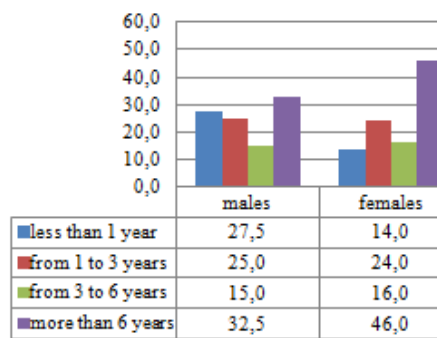
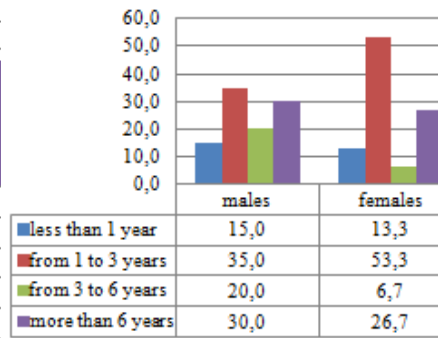


Figure 6. Percentage distribution of interviewees according to length of stay, sex and geographical origin.

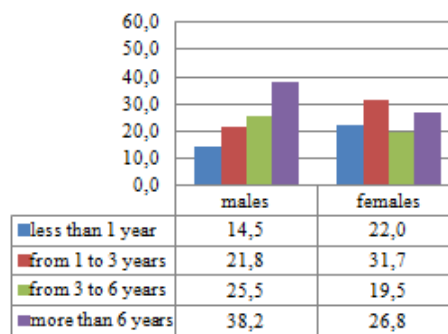
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This is confirmed by an examination of the data concerning the reasons for choosing London: for the answers immediate availability of work and necessity or desire to learn English (possibly for opportunities linked to work) there were marked variations between geographical areas with significantly higher numbers in central and southern Italy.

One expected result was the high percentages for the necessity or desire to learn the language, above all among the women. This occurs because of an inadequate knowledge of English which makes the academic qualifications obtained not immediately spendable on the labour market.

In the final analysis, it seemed opportune to investigate the most significant motivations driving the interviewees to return to Italy. The results obtained were surprising because regardless of both sex and geographical area, there did not seem to be great interest in an eventual return to Italy even with work prospects.

Yet again, however, it is gender difference which determines the rules and makes the consequent findings so curious. Specifically: in the end the links with the family of origin persuade the women more than the men to return. In addition, the territorial differences are highlighted by the possibility of immediate work which creates a strong incentive to return.

Conclusions

The empirical findings presented here have highlighted interesting aspects that emerged from the particular approach adopted by the study. Certainly the observation of the migratory process in a study of gender widens the horizons of these initial indications also making it possible to emphasise the concept of the similarity of lifestyles between the two sexes which has overturned some aspects that were formerly considered essential parts of any migratory model.

As a whole, the results suggest that the migrants interviewed are educated people with an average age of a little over 30 who, regardless of their sex and geographical origin, seek to invest in their future by taking the various opportunities available to them. Perhaps we should use the term cosmopolitan rather than emigrant, a term which is more and more remote in our vocabulary, as the figure of the migrant of the past no longer finds a place even in our imagination.

The interviewees revealed a socio-cultural background that enabled them to pursue their dreams and aspirations. Obviously, the general context in which individuals find themselves in the country of origin does not play a role of secondary importance: the decision to emigrate is frequently due to the inevitably wide differentials between the tenor of life in the country of origin and in the destination countries. This would explain the choice of London, a city which, according to the interviewees, offers a higher quality of life based, above all, on an undeniably meritocratic society.

Side by side with an analysis of a demographic nature, it was stimulating to consider some variables of a social character, and others will be examined in further studies, showing the absence today of the "traditional" Italian emigrant who was obliged to emigrate above all because of considerable poverty, often determined by the strong demographic pressure experienced by Italy in the 19th and 20th centuries. In effect, the interweaving of changes in demographic dynamics and the modifications of working life reflects those developments of recent decades which have contributed to the transformation of the population from the quantitative as well as relational point of view.

The fact is that modern day emigration is no longer a question simply of manpower, but also of "brainpower". The brain and skill drain is to be considered a further cause within the cumulative social process of migrations. In fact, this element could be added to the structural failings of the entire socio-economic system that frequently leads the migrant to pass from what is initially a temporary emigration, through various stages to one which becomes definitive. The latter will come to include the formation of a community and valid social networks with the country of origin (ethnic enclaves) which will in turn be the subject of further studies. (Goldring 1990).

In conclusion, intense and widespread mobility has become a characteristic element of the contemporary world, with specific features such as to make it more a transnational form of mobility than a true migratory phenomenon comparable to those of the past. This is despite it frequently having the same common denominator in being generated by strong motivations of an economic character.

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THE ROLE OF RESONANT LEADERSHIP IN ORGANIZATIONS

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Abstract:

The changing role of leaders and resonant leadership which is one of the new leadership approaches is investigated. It is observed that compassion, one of the three components of resonant leadership is getting an increasing attention recently in literature. A model is developed focusing on the interaction between compassion and resonant leadership within the context of the relevant variables.

Key Words: Transformational Leadership, Resonant Leadership, Emotional Intelligence, Organizational Compassion

Introduction

In general, leadership can be described as the process of directing a group of people or followers in order to attain the goals (Northouse, 2010:12). Leadership, like many other concepts, is affected by the rapid change we experience in our world. It is inevitable for leaders to change and to have different views than before especially when globalisation affects nearly every aspect of our lives; when the environmental change is deeply felt at all organizational levels; when innovation stands out and when effective and efficient use of information and human resource has strategic importance. From this aspect, the relationship between leaders and followers is getting more complex since it is important for organizations to benefit from knowledge, skill and talent of its employees. However, because of the reasons described, leadership cannot be limited to just affecting and directing people only.

Like leadership, employees are changing: their knowledge, skills and talents are increasing causing their demands to change as well. They focus on success, they demand more and more from their jobs. They are not committed only to their organizations, but also to their profession. Their perception of management is quite different than before.

All these reasons listed, in turn, changed the role of the leaders. As a result, the employees are not only the 'affected' and 'following' group anymore. The relationship of leaders and employees is at a different level, now they are in interaction. This changing role is considered as transformational leadership. Transformational leaders generate acceptance and awareness of the group's goal and mission, broaden their interests, and make employees regard the interests of the group or organization superior to their own self-interests. These leaders can achieve their goals either by inspiring their followers through their charisma or by activating them through addressing to their feelings (Bass, 1990:19-21).

Right along with transformational leadership, it is also observed that the studies on organizational communication started to focus on feelings and interaction rather than the rational and systematic side of organizational life (Miller, 2007:223). Emotional intelligence (EQ) concept was first introduced by Peter Salovey and John Mayer in 1990 and reached an academic content by Daniel Goleman^(*). Goleman described emotional intelligence as having self awareness, self management, in other words knowing what is felt and why it is felt. He also mentioned that it includes empathy and social skills, too. ([www.quixoteconsulting.com/ Training_descriptions/PDFs/emotional_intelligence.pdf](http://www.quixoteconsulting.com/Training_descriptions/PDFs/emotional_intelligence.pdf)).

In accordance with the requirements of the information age, new leadership approaches emphasizing feelings and interaction are emerging within the scope of transformational leadership.

One of these new approaches is “resonant leadership“ which is based on the emotional intelligence concept. Resonant leadership has three dimensions which will be discussed in the following sections: mindfulness, hope and compassion. Actually it can be thought that all leaders must somehow possess these features. But the feature that distinguishes resonant leaders from others is being able to use these through their emotional intelligence (Lutzo, 2005).

Everybody is exposed to painful events throughout their lives such as the death of a relative, natural disasters, financial problems, illness or organizational problems like downsizing (Madden, Duchon, Madden and Plowman, 2012:689; Lilius et al., 2008:193; Frost, 1999:128). Although there is the expectation of not bringing the feelings to work, people take their pain and grief with them wherever they go (Frost et al., 2005:843). When it is thought that the time spent at work covers a big part of our daily lives, it can be stated that the organizations are important places for healing or mitigating the pains. Although one might think that there is generally pain and grief in organizations, they can also be considered as places of healing, where care and compassion is given and taken (Kanov et al., 2004:809).

Pain and grief creates financial, psychological and social costs to organizations and employees (Dutton, Lilius and Kanov, 2007:110). According to Zaslow (2002), firms are experiencing cost of \$ 75 million yearly because of absenteeism and low efficiency of their employees caused by their sorrow (Lilius, Worline, Dutton, Kanov and Maitlis, 2011a:874; Lilius et al., 2008:194). Therefore, the effect of compassion will not only be at the emotional level, but also financial. Additionally, compassion is a concept which seems to be discussed a lot in literature lately. For example, the journal ‘American Management Review’ assigned the last issue of 2012 totally to compassion. Because of the reasons stated, the compassion dimension of resonant leadership is studied in detail in this paper.

In today’s materialistic and individualized world, everybody needs compassion from time to time in their lives. Therefore the importance of compassion from both the individual and organizational aspects and some organizational practices to apply resonant leadership effectively are suggested in this study.

What is Resonant Leadership ?

Today’s leaders face a much more unstable and uncertain world in comparison to the past few years. Social systems that met the needs of families, societies or nations for a long time have not been functioning well anymore. Local conflicts are nowadays being observed at the global level (Boyatzis and McKee, 2005:1). However, like all the other changes, such big changes include opportunities as well. To be able to benefit from these opportunities, leaders defined as resonant have proven to have the ability to act properly even in uncertain conditions and give inspiration to people working with them, their institutions, and other groups. In that respect, resonant leaders, a sub category of transformative leaders, set new goals in challenging conditions and give hope instead of acting discouragingly or alarmingly. These leaders activate others in a powerful, passionate and targeted way and work in resonance with them. In other words, they communicate very well. At this phase, emotional intelligence plays an important role in constituting and retaining such relationships (Boyatzis and McKee, 2005:3).

Resonance literally means the intensification and prolongation of sound by vibration (<http://www.thefreedictionary.com/resonance>) . Resonant leaders, when they are in harmony with others, think, feel and head towards their targets in the same way with them. They are emotionally in tune with the people around them (Lutzo, 2005). According to Boyatzis and McKee (2005), resonant leaders are great leaders. They are believers, they conserve their values and live passionately. Resonant leaders communicate well with people they are working with, which enables them to work harmoniously and share their ideas and feelings about what to do and why to do. Leaders who can create resonance improve their emotional intelligence either instinctively or by working hard. In other words, they have improved themselves in issues such as self-awareness (realizing their own emotions, knowing their strong sides and limitations), self-management (being able to control their emotions, flexibility and adaptability), social awareness (empathy, organizational interest and responsibility) and relationship management (Boyatzis and McKee, 2005:4).

In addition to the ability to know and manage themselves, emotionally intelligent people manage other people’s emotions and have strong and dependable relationships with them. They know that emotions are contagious and their own emotions affect others’ emotions and accordingly their

performance. They are aware that people can be activated by fear or anger, but this type of activation will not be effective in the long term and the employees will feel less worthy, and hence will create an organizational climate in which they do not focus on organizational targets effectively (McKee and Smith, 2006:26). Such leaders develop empathy and behave according to the information they gather by looking at the issues from different perspectives. By addressing emotions of others, they give them hope and encourage them to do their best and cooperate with others (Boyatzis ve McKee, 2005:4; McKee and Smith, 2006:26). They are not defensive. They are broadminded and aim to improve and learn about themselves. They are also ready to change their behaviors.

To get an effective performance in organizations, resonant leaders blend financial, social and intellectual capital in an effective way. However, the most important thing is that leaders succeed in behaving that way. Naturally, to be a great leader, it is necessary to know and understand the market, technology, people, and other factors affecting the organization. However, knowing all about these is not adequate for an effective and sustainable leadership. It is just at this point that the notion of being resonant matters. Being resonant enables leaders to use their expertise for the performance of the organization. It also enables leaders and others both in and out of the organization to support each other (Boyatzis and McKee, 2005:5). Resonant leaders through their positive way of thinking and clear vision inspire others by helping them to have strong emotions.

However, it is very difficult to have and sustain resonant relationships in today's demanding and stressful world. Good leaders who have been able to reach resonance have had to sacrifice a lot. In fact, this is the truth underlying leadership. This notion, also called Compromise Syndrome, may cause leaders' ability to empathize and being open to others to lessen and sometimes affect their cognitive functions and decision making abilities negatively. Getting over this situation requires a process in which mind, body, heart and soul take part. A person should be first aware of himself despite tough conditions and long working hours. This means renewal (McKee and Smith, 2006:26).

In their study, Boyatzis and McKee concluded that three concepts are needed to ensure and sustain resonance. These concepts are mindfulness, hope, and compassion.

Mindfulness: Mindfulness means leading a life by developing a complete and conscious awareness for oneself, others, environment, and work. Indeed, it means perceiving ourselves and the world around clearly, 'being awake and aware' (Boyatzis and McKee, 2005:9).

Hope: Hope enables us to believe that our goals are achievable and to motivate and inspire others to reach those goals while trying to realize our goals (Boyatzis and McKee, 2005:9). Thus, it becomes possible to be hopeful and inspiring in this indefinite world of business. People may dream about a better and achievable future, believe they will attain it and develop an optimistic point of view.

Compassion: Compassion helps people to include their emotions during the process of thinking, deciding and acting by understanding others' wishes and needs. They empathize by putting themselves in others' position. It is one of the characteristics of the resonant leaders to treat both the ones they serve and the ones who serve them with empathy and compassion when they face difficulties or when they have opportunities (Boyatzis and McKee, 2005:9).

Compassion

Arguments about compassion date back to early ages. Although religions have different philosophical views, the notion of compassion is observed to have an importance in all religious books and discourse. It is not only mentioned in the holy books of three big religions but also in Buddhism. Moreover, Dalai Lama regards compassion equal to being human. (Frost, et al. 2005:845; Lilius, Kanov, Dutton, Worline and Maitlis, 2011b:5; Kanov et al., 2004:809). According to Armstrong (2011), compassion is in the heart of all religious, ethical and spiritual practices, advising us to treat others in the same way we want to be treated. (Rynes, Bartunek, Dutton and Margolis; 2012:506). Aristotle defined compassion as the emotion directed at others' suffering and indicated three necessary factors: perceiving others' suffering seriously, believing this suffering is not deserved, and believing that a person can suffer from the same thing (Frost et al., 2005:845). Even Adam Smith, described as the saint of self-interest from time to time, mentioned positive effects of compassion in his articles (Rynes et al., 2012:506).

Studies about compassion in management started with the article by Peter J. Frost in 1999. Compassion meant sharing suffering with others, wishing that events causing that suffering will not happen again, and trying to find ways to help sufferers. It is lexically defined as wishing to soothe

others' worries, being affectionate and sympathizing with them (Frost, 1999:128). The thought 'it could have been me' is the basis and one empathizes the other by thinking that he/she could have been subjected to that unfortunate event (Snow, 1991:197). Besides, scholars studying the same issue state that compassion comprises interest (via communication and behavior) and connection to others held by empathy. Compassion enables us to help others and helping others makes us happy. Kornfield (1993) specified compassion as 'the heart's answer to pain' (Miller, 2007:226).

At the individual level, compassion is comprised of a three part process that includes noticing, feeling and responding (acting) (Dutton, Worline, Frost and Lilius, 2006:60; Kanov et al., 2004:812). Compassion exists only if all of these three steps occur.

At 'noticing', it is required to become aware of other's emotional state by being open and attentive (Frost et al., 2005:847). 'Noticing' has special importance since it is the first step of this three part process. According to Clark (1997), we evolve awareness mainly for people similar to us or when we experienced similar pain or grief. Like Frost (2003) stated, sometimes we are so busy with our daily lives that we are unable to notice what is happening in front of us (Kanov et al., 2004:813). Being unable to notice another's pain will inhibit compassion to occur, although there is capacity of feeling and responding.

Feeling is the second step of compassion. The intensity of feelings can differ from person to person. According to Clark (1997), feeling can be in various forms: worry, anger on behalf of other or feeling guilty for not being able to do more (Kanov et al., 2004:813). At this step, the significance of empathy has to be mentioned. When we feel empathy, we put ourselves in suffering person's position and look from his or her perspective (Frost et al., 2005:847). However, noticing somebody's pain does not always lead to feel compassionate. We can see him/her suffering, but may not feel anything, we can even think that he or she deserved it (Kanov et al., 2004:813). Therefore, in order for this 'feeling' step to happen, we must take the situation causing pain as serious (Snow, 1991:198). From this view, it can be said that noticing may not always lead to feeling, compassionate feelings may not evolve depending on the situation and conditions.

Responding is the last step that involves an action towards easing other's pain or supporting him/her (Frost et al., 2005:847; Dutton et al., 2006:60; Kanov et al., 2004:814). It is responding, acting or trying to help which makes compassion and empathy different from each other (Atkins and Parker, 2012:525). Responding may be in different ways like emotional support, advice or help in a way (Miller, 2007:227). Visiting someone who lost a relative at his or her home and sharing his pain; consoling a colleague who is just divorced or undertaking an ill colleagues' workload are examples of different ways of helping. However it is important to undertake these with the feeling of compassion. One can behave this way just because of the society's expectation and the need of being accepted (Kanov et al., 2004:814). Sometimes compassion can be felt, but people cannot respond because of unfamiliar environment or since the situation does not allow people to act in that way (Atkins and Parker, 2012:525; Kanov et al., 2004:814). For example, a new employee may hesitate to act compassionately on his first day of a new job, although he feels compassion towards his colleague who lost his mother.

Organizational Compassion

Organizational compassion can be defined as collectively noticing, feeling and responding of members of a system to pain and suffering of other members in the same system. In order to be able to talk about collective responding, it must be legitimated and coordinated among people. This kind of coordination and legitimacy can be achieved through organizational values, practices or standards. So, inspecting organizational compassion will also show the capacity for collective noticing, feeling and responding (Kanov et al., 2004:810).

Collective Noticing

It is the acceptance of the existence of pain and grief in a system, by the members of that system with a shared value. Of course the role of individuals are important, since organizations cannot notice pain. In other words, collective noticing is a social process beginning with noticing a colleague's pain individually and ending with developing awareness by all organization members (Lilius et al., 2011b:8). However it also has to be mentioned that organizations play a critical role in this process since they affect their members through several systems and practices (Kanov et al., 2004:816). Even the architecture is important since it affects the accessibility. Organizational systems and technology can be considered also as significant because they enable the communication of pain

in the system. For example, working in an open office is more suitable for creating awareness, compared to single offices. It can be said that organizations having these kinds of features have collective noticing capacity, relatively (Kanov et al., 2004:817). Similarly, announcing an employee's loss or similar pain by e-mail or systematically with help of technology is a way to increase the capacity of collective noticing.

Collective Feeling

Collective feeling can be observed in organizations where people can easily express their feelings and share their work experiences and private life. However, the atmosphere must be suitable for sharing the emotions freely and openly. Organizational practices, organizational culture and leadership play a critical role in creating this kind of atmosphere (Kanov et al., 2004:818). An example of organizational practices could be the meetings where not only issues related to work but also emotions are discussed. According to Meyerson (1994), sharing and expressing the feelings will evoke collective emotions (Kanov et al., 2004:818). So feeling, the second step of compassion, will become collective by spreading from person to person.

At this stage, the importance of organizational culture cannot be ignored. The atmospheres where pain and grief can easily be expressed enables people to create empathy. As a result, compassion will be intensified and quicker and effective healing is expected to occur.

Leadership will contribute to collective feeling stage as well by being a role model. Following their leader's behavior, employees will behave more compassionately towards their colleagues who experience pain or suffer (Kanov et al., 2004:819). Resonant leaders will have a natural role in creating organizational compassion since they already got resonance through compassion. At this point the importance of leader's personality has to be mentioned. There are many researches showing that personal traits are associated with leadership emergence and effectiveness. Therefore it is worth to mention that personality will have an indirect effect on organizational compassion by affecting leadership behavior.

Collective Responding

Collective responding points out legitimated, but most important coordinated behavior. The coordination mentioned can be executed by someone or a group, and can be developed suddenly because of an unexpected event (Kanov et al., 2004:820). An example could be offering condolences to a colleague who lost his relative by visiting him or her collectively during working hours. Like at the feeling stage, organizational culture and leadership play a significant role in spreading and legitimating it. Additionally, some organizational systems may support this kind of collective behavior. For example, publishing stories of the employees in a hospital who behaved compassionately against patients may increase the probability of others to feel compassion for patients, clients or colleagues. Being able to transfer off days or bonuses to colleagues who need these, can be an example of legitimated and coordinated behavior (Kanov et al., 2004:820).

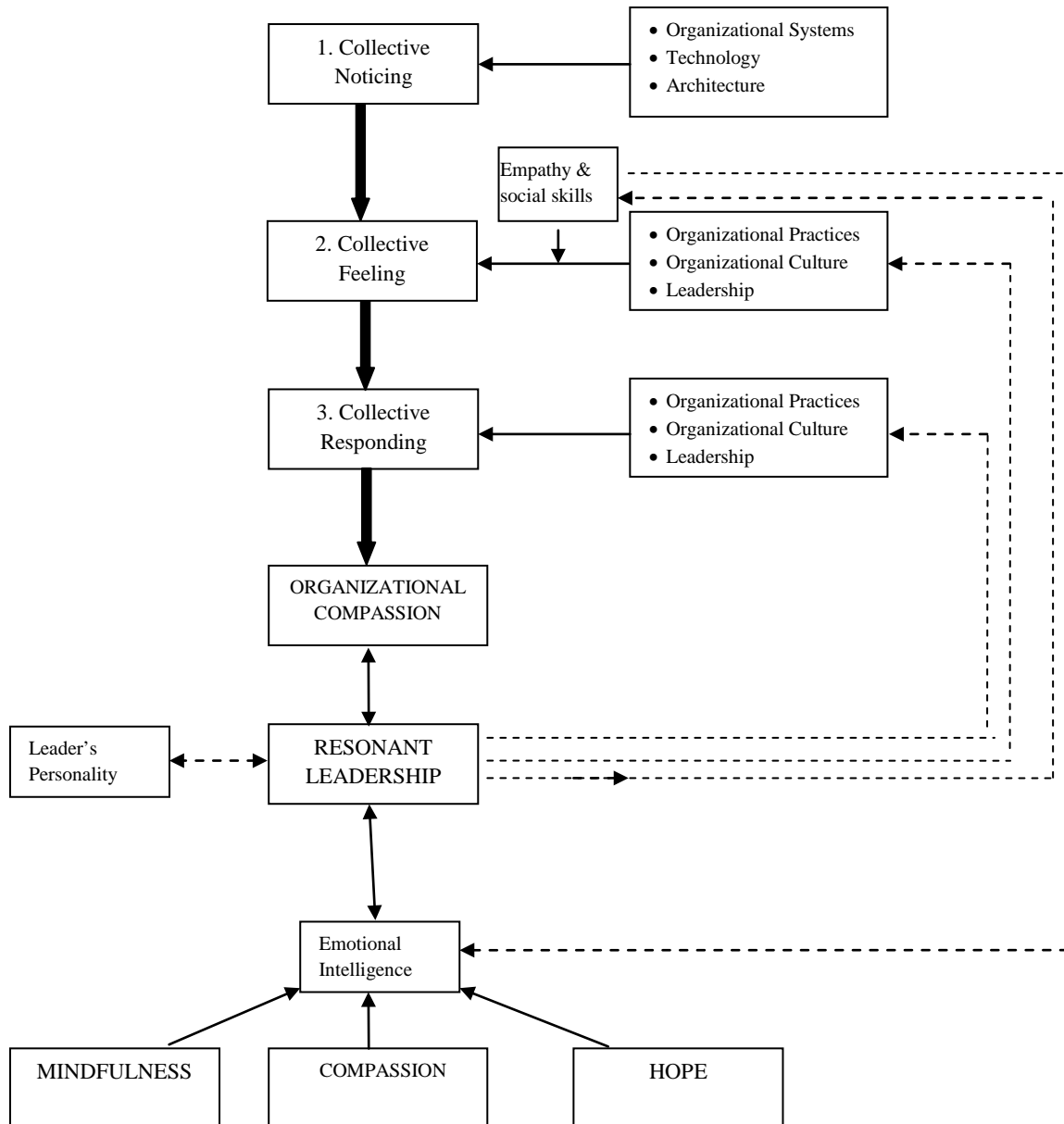
Besides this, celebrations in organizations, charity atmosphere or applying collective decision making methods may enhance the quality of relationships among the employees and increase the probability of feeling compassion (Lilius et al., 2011a:891). At the same time, behaving or being behaved with compassion may create positive spiral; thus cause similar behaviors to become widespread and increase its positive effects (Dutton and Workman, 2011:402). Moreover, it may have an emotional effect on the person observing it by referring to his feelings (Frost, 1999:128). But there is one important point not to forget: in order for organizational compassion to occur, all of these stages must be executed collectively, have to be legitimated and coordinated.

Resonant Leadership- Organizational Compassion Relationship

The figure showing the relationship between the resonant leadership and organizational compassion within the context of relevant variables is given below.

Organizational compassion is a three step process consisting of collective noticing, feeling and responding. The first step is collective noticing, where organizational systems, technology used and even the architecture of the building has an important role.

Resonant Leadership- Organizational Compassion Relationship



The second step is collective feeling, with an important feature of developing empathy towards suffering person. Here, organizational practices and organizational culture have significant effects, and it is also the step at which the resonant leadership comes into play. Since resonant leaders, with their emotional intelligence and personal traits, should reach resonance and be in tune with employees through compassion, it can be easily said that they might automatically be a good role model for others and might increase the probability of collective feeling to take place. Leaders are also effective upon the organizational culture, therefore it would be plausible to state that they will have dual effect on collective feeling, resulting in the creation of common values accepted by all members in the system.

This situation will be valid also for the third step: collective responding, where again organizational culture and leadership, as well as organizational practices become prominent. Leaders may be a role model for others and increase the probability of collective responding. Since they will be effective on organizational culture, they might have again a dual effect on collective responding stage.

As a result, it is evident that leaders, especially resonant leaders have a critical role in creating organizational compassion. However, the opposite can also be possible: Organizational compassion may help leaders to be in tune with others and reach resonance.

Conclusion

Leadership is affected by the rapid change in today's world. In this context, one can expect new leadership approaches to emerge. One of these new concepts is resonant leadership, which is based on emotional intelligence. Resonant leader is in tune with others by using his emotional intelligence. In this study, the interaction between the resonant leadership and compassion, one of its dimensions, is investigated in detail and a model is developed. The model indicates the necessary prerequisites for resonant leadership and organizational compassion to emerge within the context of all relevant variables. However it also has to be noted that the studies on both issues are quite new. Therefore there may be a need for this model to be revised in light of future research.

The objective of the study was to drive attention to both of the concepts of resonant leadership and organizational compassion. From this point of view, it is suggested that there is a major need to work on the effects of organizational compassion and resonant leadership upon the organizational climate, organizational citizenship, organizational commitment and on many other organizational issues since these concepts are critical for the successful performance of organizations.

(*) Daniel Goleman, who had studied emotional intelligence, also worked on resonant leadership together with Annie McKee, and Richard Boyatzis in their book entitled 'Primal Leadership- Realizing The Power Of Emotional Intelligence' in 2002. Boyatzis and Mc Kee continued their studies on this subject and published a book entitled 'Resonant Leadership Renewing Yourself and Connecting with Others Through Mindfulness, Hope and Compassion' in 2005.

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JOHN MASTERS – A VOICE FROM THE COLONIAL PERIPHERY

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Abstract:

This article discusses three novels by John Masters (1914 - 1983), an ardent advocate of the British Empire. Through the characters and situations he creates, the author promotes the idea of British imperial commercialism. Masters experienced a typical life of a fifth generation English settler in India: having spent only a short period in England, the ruling center, when he was sent to school, he only knew the social and political conditions of the colonized periphery, which turned him into a unique chronicler of the Anglo-Indian history. The novelist uses the history of the East India Company, an institution that helped the Empire to succeed, as the subtext of his novels. As an ardent advocate of the Company's rule, Masters uses his novels to laud the English, as their presence in India means the improvement of living standards to the local inhabitants. *Coromandel!* (1955) presents the beginnings of the East India Company in the 17th century. In *The Deceivers* (1952) Masters shows how the Company developed into a huge administrative institution that had its own army and a well-functioning and incorruptible Indian Civil Service. In *Nightrunners of Bengal* (1951) Rodney Savage is proud that everywhere in India he is surrounded by 'symbols of the colossal empire of the Honourable East India Company'. Yet, the Indian Mutiny of 1857 ruined the Company's privileged position and it lost its administrative powers. As Masters is one of the few voices from the colonial periphery, his contribution to modern literature is unique.

Key Words: Colonial, East India Company, centre, periphery, imperialism

Introduction

On the 15 August 1947 the partition of India became a historical fact and the British Indian Empire dissolved. Starting the postcolonial period in the relations between Britain and India, the event had an enormous political, economic and cultural impact on both the British and the Indians. Obviously, the new political situation also affected the literatures of both the center and its periphery. However, while Indian authors writing in their independent country have proved deeply involved in describing and analyzing the four-hundred-year-long period of Anglo-Indian colonial system, (see , e.g. Ralph Crane, 1992), British authors publishing after 1947, seem to be fairly reluctant to discuss their colonial history and relatively few have chosen to deal with the Anglo-Indian colonial past. Among the latter Paul Scott (1920-1978), J.G. Farrell (1935-1979), M.M. Kaye (1908-2004) and John Masters (1914 - 1983) are the most influential British authors writing about India in the postcolonial period of Anglo-Indian history. Like Kipling, Kaye and Masters were born in India, and lived there until the late 1940s. In the new political situation after 1947 Kaye chose to settle down in England, while Masters moved to the United States.

Masters wrote nine novels about Anglo-Indian history, but so far his books have not been critically analyzed and his contribution to postcolonial literature remains on the margin of the colonial/postcolonial discourse. Masters experienced the typical life of a fifth generation English settler in India: having spent only a short period in England, the ruling center, when he was sent to school, he only knew the social and political conditions of the colonized periphery, which turned him into a unique chronicler of the Anglo-Indian history from its beginnings in the 17th century till the 1960s. Masters' early novels were written in the tradition of the American dime novel, a mass market paperback targeting popular reading audience, with the difference that Masters did not have to look for inspiration in story papers, but used his own knowledge of Indian history. Masters' first novel

Nighthtrunners of Bengal was published in 1951 and was widely sold in America; the American Literary Guild, a mail book club selling cheap editions made the novel its Book of the Month. In this way, Masters wrote his first bestseller. Discussing the situation of popular novel in America John Sutherland creates the following definition of the bestseller:

Very largely speaking, the bestseller has two functions. The first is economic. It exists to sell the best and make money for its producers and merchandisers. The second, more flexible function is ideological. The bestseller expresses and feeds certain needs in the reading public. It consolidates prejudice, provides comfort, is therapy, offers vicarious reward or stimulus. In some socially controlled circumstances it may also indoctrinate or control a population's ideas on politically sensitive subjects. In other circumstances, especially where sexual mores are concerned, it may play a subversive social role, introducing new codes and licence.. (1981 , 2012: 22)

Masters explored both the economic and ideological aspects mentioned in Sutherland's definition. The ex-soldier of the British army in India started writing novels about India and its history in the 50s of the 20th century to earn his living in his new life situation in America, using his imperial roots and his nostalgia for the British Empire as the main source of literary inspiration. As an ardent advocate of the British Empire Masters makes an attempt to rewrite Anglo-Indian colonial history, and his novels prove that the author respects the metropolitan centre in London, but identifies with the periphery, the colonized India and its complex racial and cultural structure.

Peter Morey, one of the very few critics discussing Masters' contribution to postcolonial British literature, remarks that the novelist rewrites history in a way showing that 'imperialism was a good venture'(Morey 2000: 81). And Ralph J. Crane characterizes him as 'a fine storyteller'(Crane 1992: 23), who 'excludes the present from his story' (ibid.). Through the life of one family Masters makes a successful attempt to trace 400 years of British colonial presence in India. All his Indian novels portray members of the successive generations of the Savage family; some of them serve in the British Army, others are civil servants of the British administration in India, but whatever their occupation is they serve and guard the institution on which the English Empire was built: the East India Company, which received its Royal Charter in 1600 and continued its trading activities for nearly 300 years, constituting the economic scaffolding for the Empire 's political growth and successful development.

Main Text

This article aims to examine Masters' three early novels *Nighthtrunners of Bengal* (1951), *The Deceivers* (1952) and *Coromandel!* (1955), which illustrate the rise and fall of the East India Company, the symbol of English imperialism, and its role in the Indian colonization process which is presented by Masters as a way of personal advancement and social and economic success. *Coromandel!* (henceforth abbreviated as C) begins Masters' rewriting the history of British imperialism. Coromandel means *The realm of the Cholas*, a 13th century dynasty - *Cholamandalam* in Tamil. It is very likely that the Europeans, especially the Portuguese, who arrived at the Bengal Coast in the 15th century, corrupted the original name into Coromandel. In Masters' novel Coromandel functions as an objective correlative for the need of freedom and fulfillment of the most incredible dreams shared by the generation represented by Jason Savage and his peers. Jason, a farmer's son, who can't read and write, lives in the England that has already started building its imperial and colonial history.

Masters sets his novel in the period of 1627 -1629. By 1627 Drake, Gilbert and Raleigh are cult figures for discovery and overseas exploration - an acquaintance of Jason's 'had sailed with Drake'(C 6) and Jason keeps imagining himself sailing on his ship; England has settlements in North America and the Caribbean Islands and trades with Asia through a private trading company, the English East India Company. After King James I signs the Treaty of London in 1604, Spain ceases to be England's rival in India and the East India Company gains new space for its commercial activity becoming very active in its trading operations. When the Portuguese are ousted from the Coast by the Dutch and the English, the "First British Empire" gains its impact. The events connected with the process of removing the Portuguese from the coast, the competition between the Dutch and the British and the establishment of the East India Company as a powerful economic and political force representing British interests in the area constitute the historical background of the novel.

In *Coromandel!*, which is both a historical and a picaresque novel, the protagonist, young Jason Savage functions as a model of all those Englishmen who had the courage to participate in the

colonization process, presented by Masters as a chance to get socially and economically promoted. Jason leaves his little village in Wiltshire, goes to London, and then by sea travels to the Coromandel Coast, gathering on the way experience and knowledge. Jason is a peasant's son, but he is very ambitious and does not accept the stiff social hierarchical divisions of the 17th century England. He dreams not only about improving his social and financial situation, but he dreams about leaving his father's farm, about faraway travels as 'There was so much to know, and he knew nothing except to be a farmer's son in Shrewford Pennel' (C 7).

When Jason's ship arrives at the Coromandel Coast Jason gets unintentionally involved in the political events. Jason's captain, Drayton, sails off the coast to avoid a fight with the Portuguese ship *Isabella*, but Jason jumps overboard, because he has fallen in love with an Indian girl Parvati, who is a spy of the local Indian King. Yet, both Indians and Portuguese believe he is 'an envoy of Master Drayton's – an ambassador from King Charles' (C 146).

As a strong supporter of the British Empire, Masters rarely uses irony while describing the English in their colonies, however, in the character of Jason, the author seems to be, to some extent, criticizing the English sent to the potential colonies for their overconfidence, lack of experience and for relying on their dreams rather than facts. Ironically, the direct reason that makes Jason leave his village in England is Old Voy's map showing the place at the Coromandel Coast, where an incredible treasure is hidden. So he sets off to pursue a dream he bought from Old Voy, a local cheat and scamster. Since he is not a shrewd entrepreneur or a skilful politician he painfully learns on the spot that in spite of appearances 'Nothing was simple and straightforward here; nothing was what it seemed' (C 147). Jason boasts to himself that 'he was no fool, especially that he was learning to put aside dreams and concentrate on things that mattered, like money and power' (C 147), but he is not able to help the poor pearl-ers, or notice that he is manipulated by the local Indian King who 'was expecting the English to make an arrangement with him, by which the Portuguese would be got rid of' (C 145).

Masters' protagonist gets easily impressed by the beauty of India, its riches and its women, but Masters does not allow him to forget about his national pride. On his journey Jason is surrounded by many foreigners; he mixes with Indian Kings and Dutch military officials; he has Indian lovers, and a Portuguese wife, but in difficult moments he always remembers 'He was English' (C 194). When the Dutch defeat the Portuguese and the Indian kings, Jason has to leave the Coromandel Coast, but he does not leave India. When he fails as a politician he returns to pursue his dream about gaining wealth. When he learns to read he finds out from Voy's map that the real treasure is to be found on the Mountain Meru and he continues his journey accompanied by his wife Catherine. They travel through Bengal and reach Tibet to climb Mount Meru. Voy's map is like a fairy tale, but the journey itself turns Jason into a man of knowledge and experience, who is able to make real maps of India and help to strengthen England's influences in India. Philip Wegner notices that 'knowledge in the imperial world system, as we already know from Said's *Orientalism*, is a form of power' (Wegner 1993-4: 146) and during his journey around India, Jason gradually learns to make the best use of the knowledge he gains. Although the British get defeated at the Coromandel Coast, two years after his arrival in India, Jason is convinced he wants to stay in the country and be useful, for everything, every sort of career, is available to an Englishman in India:

Soon we'll be back in Agra. I don't know what will become of me nor what I will do, except that I will live my life and find it wonderful. I may be an equerry in the household of the poet-empress. I can set myself to explaining the English to the emperor, or the emperor to the English.(...) I can be a scholar or a general or a merchant or a physician, or all of those at once. I can make maps and write books. (C 298)

Although in 1628 the English are defeated by the Dutch and Jason has secretly to run away from the land of his dreams, soon the British manage to work out a 'new Anglo-Dutch arrangement' (Ferguson 2004: 24) and 'on a shore site acquired in 1630, the company built a fort which, as if to advertise its Englishness, was christened Fort St George. Around it would spring up the city of Madras (*ibid.*). The first settlers prepared such good maps that they allowed the East India Company to expand and rule over most of the Indian territory in the 18th and 19th centuries.

The history of the East India Company is used by Masters as the subtext of *The Deceivers*, set in 1825. The story of *Coromandel!* ends in 1629 and *The Deceivers* take the reader to the mid-1820s when in the first decades of the 19th century after the turmoil of the 18th century fights, the East India

Company's position became very strong, developing into a huge administrative institution that had its own army and a well-functioning and incorruptible Indian Civil Service:

In 1803, following the defeat of the Marathas at Delhi, the Mughal emperor himself finally accepted British 'protection'. By 1815, around 40 million Indians were under British rule. Nominally, it was still a company that was in charge. But the East India Company was now much more than its name implied. It was the heir to the Mughals, and the Governor-General was the *de facto* Emperor of a subcontinent. (...) They had robbed the Spaniards, copied the Dutch, beaten the French and plundered the Indians. Now they ruled supreme. (Ferguson 2004: 51)

The main protagonist of *The Deceivers* (henceforth abbreviated as D) is Jason's great, great grand-son William Savage, who like his great, great grand-father William is a man of action. The novel begins at a crucial moment in the character's life: William is getting married to Mary Wilson, whose father holds 'the office of Agent to the Governor-General of India' (D 8), and so decides to change his professional career: Captain Savage plans to turn into a civil servant working for the East India Company.

In the figure of William Savage, Masters presents a new type of an Englishman, an Englishman born in India (like his own father, grandfather and great grandfather), who identifies with the colonial periphery and treats it as his real home rather than England, the ruling center. *The Deceivers* is narrated by an omniscient third person narrator, and all the events are focalized through William's consciousness. In this way Masters allows his Anglo-Indian character, a representative of the periphery to speak and make it obvious that he is aware of the fact that because he was born and raised in India, he is different from his English acquaintances, although he is the colonizer. The wedding is a good occasion to confirm his conviction that he no longer feels himself to be part of the culture and tradition of the center: 'He was in a tight circle of English faces, English customs, English values, and he could not find happiness or success here. He had tried many ways and failed' (D 10-11) William looks forward to the moment the whole ceremony is over and enjoys the thought that 'Tomorrow he and his bride would be on their way out there, through the hills, to his own people' (D 11). Yet, he cannot be said to have gone native, like Kipling's Kim or Scott's Saxby. On the contrary, Masters emphasizes his character's Englishness in every sphere of everyday life: he wears English clothes, at the wedding he is dressed in his army uniform, he is warm and friendly towards his Indian servants and coworkers but he does not imitate Indian ways of behaviour. His lifestyle proves he belongs to the Westernized sphere of culture and religion. When his Indian official congratulates him on the wedding and compliments his wife's beauty he makes sure: 'It is not rude of me, by your custom, to say she is beautiful? A princess!' (D 19), which shows that the local Indians are used to respecting his special position. When the local Indians greet them in their village, their band plays "Rule, Britannia". Mary cannot recognize the tune and finds it funny when her husband reminds her of its title. Yet, he does not feel offended by Mary's ignorance, because 'Perhaps he too wouldn't have recognized the tune if he had not heard bands like this one play it so often' (D 21).

But first of all, William is proud of being an English civil servant employed by the East India Company, and he is deeply concerned about its employees and policy in India: 'He was a servant of the Honourable East India Company, and that huge organization was as torn by indecision as he was' (D 29). He criticizes George Angelsmith, his rival in love and career, because he does not know his Indian staff and the area under his jurisdiction – 'It always astonished him that the people at headquarters should know so little about the districts' (D 17). Obviously, George Angelsmith is William's antagonist in the structure of the novel, introduced to show two various attitudes in profession of the Englishmen employed by the Company. George seems to be a newcomer from England, who has come to India to enjoy a fast and profitable career of an accredited representative of the Agent to the Governor-General of India, who will soon become an agent himself, whereas William, born in India, is just a Company's official responsible for a small village, but as Kipling makes one of his characters remark, the most efficient servants are those who 'know the land and the customs of the land. The others, all new from Europe, suckled by white women and learning our tongues from books, are worse than the pestilence' (Kim, 104)

While William cares about the Indians he is responsible for – 'It was very easy here to imagine that everything was your business' (D 17), George remains uninvolved and waits for others to tell him 'if it's any of our business' (D 17). William's respect for Indians is his great advantage over George. He feels 'there was an affinity' (D 24) between himself and Chandra Sen, his Indian deputy.

William is convinced the Indians from his district trust and respect him, so he is extremely satisfied when he notices distaste in the Sen's eyes, 'because the distaste in the large eyes was for the smart, the clever, the brilliant George Anglesmith' (D 24). Interested in his own promotion only, George does nothing to help Savage deal with the difficult problem of Gopal's wife planning to become suttee the next day. He leaves it to William and his only advice is 'As far as I can see, it ought to be easy enough. Just go down there and tell 'em not to' (D 28), which proves that being a true colonizer he believes the English are entitled to show their absolute authority over every aspect of the natives' life. In contrast, William is full of doubt how to approach the problem. Having more knowledge of Indian religion than George, William hesitates whether he has enough authority to prevent the suttee case. He is supported by Chandra Sen, who tries to explain the situation to the guest.

Simultaneously, as an ardent advocate of the Company's rule, Masters uses the situation to laud the English, as their presence in India means the improvement of living standards to the local inhabitants. Masters makes Sen express his opinion which contains one of the commonly repeated excuses for English presence in India, namely, that only the British authority can allow Indians live in peace. Chandra Sen says

Here the people are so pleased with the new security, the first there has been in living memory, that they have found time and energy to complain about the things they do not like. Ten years ago they struggled from dawn to dusk, from sowing time to reaping time, just to keep alive, and dodge the freebooters and robbers, and fend off new tax extortions. Do you know the Saugor Pandits made me collect, and pay, twenty-seven different kinds of tax in a *good* (italics in the text) year? Now the people have a little time to think. And no one fills their mouth with gunpowder and explodes it if they make a protest about something. Life has changed under your benevolent government. Much is for the better. But the people want this changed and that left alone. In this matter of suttee they are ready for violence here. (D 28-29)

Putting the words into an Indian character's mouth shows that Masters believed the Indians were, or at least should be, grateful for the Company's rule (the raj) in India, but at the same time, he makes Sen point out that natives should be left a margin of freedom in some matters, for example, religion. William, who knows India and its traditions thoroughly, finds it very difficult to define his own stance on the problem whether to use his authority of the Company's official and a Christian, so a representative of entirely different religious and cultural values, to solve the problem, or leave it to the natives: 'Suttee was the people's custom and religion; only an act of despotic power could abolish it. Yet, could Christians, having power, tolerate wilful self-murder?' (D 26) William mustn't allow on an outbreak of violence, because riots would undermine the Company's position. In case of unrest, the Army would have to get involved and if any Indians got killed, the whole community would turn against the English.

William is aware that his position in the system of the Company is not very strong and he cares about his father-in-law's opinion. He worries – 'What will Mr. Wilson do if the wife of Gopal the weaver becomes suttee? How much deeper will this affair load the scale already weighted against me by adverse appeal rulings, mismanaged settlements, long-delayed civil causes? He was not a very good paper official, and he knew it' (D 31) Being in such a low state of mind William eagerly accepts Chandra Sen's suggestion that if the woman could see her husband alive, she would not kill herself. And since to Sen, who is a native, William looks 'like Gopal the weaver' (D 31), the Indian tries to convince William that 'With a little care, I do not think you could be told apart in the best light. In the dusk, never' (D 31) The trick with the camouflage works and Gopal's wife is stopped from becoming suttee.

But the suttee episode is a technical trick used by Masters to introduce William to those aspects of life in India that have been hidden from him when he is perceived as the Other by the Indians. When he pretends to be one of them he must also share their dark secrets, thanks to which he has a chance to contribute to the security of the Company's dealings in the area. On the way home he is stopped by a man who knows Gopal and who makes William watch an act of murder committed by a gang of Thugees, the Deceivers. In the Glossary to his novel Masters explains that a Thug was 'a member of a religious association devoted to highway murder and robbery; *Thuggee*, the association and its acts' (D 286). In the historical background, the Thugees derived from the religious cult of the goddess Kali:

The Thuggee cult was devoted to Kali, the goddess of death and destruction. For hundreds of years the Thuggee cult practiced an organized campaign of assassinations. Strangulation was the preferred method of choice. Thugees claimed tens of thousands of victims over a 300 year span. ... Though sporadic attempts were made to the extinction of the gangs it was not till Lord Bentinck (governor general of India 1833-35) took vigorous steps that the system was seriously attacked. Between 1831-37 the British hanged nearly 4000 Thugees and the cult was **presumed** eradicated. (<http://www.sepiamutiny.com/sepia/archives/000322.html>)

Masters sets his novel in the period between February 1825 and April 1826. According to his interpretation of the historical events, the British only then become aware of the gang's existence and start getting prepared to fight the Deceivers, who pose a serious danger to the Company's prosperity. Captain Savage admits that

In the nine years of the English Company's rule nothing had been done against the Deceivers. But William realized now that most Indians knew at least of the existence of the Deceivers; and, knowing, they could not believe the English did not also know; therefore the English officials too were sharing in the spoils. (D 240)

For several months since February till September William makes preparations to catch the members of the gang, but he has too few men at his disposal. His wife suggests he should

Raise a corps of volunteers! Compel all the important men in the district, Chandra Sen and all the others, to subscribe to a fund for paying more police. Threaten everyone with extra taxes. Hint that you'll decide cases against anyone who doesn't give money or spend a day a month patrolling the roads' (D 84) .

Destroying the Deceivers' gang in his district and attracting the authorities' attention to the problem William Savage can enjoy his sense of power and success, which at the same time is the power and success of the East India Company, whose position and operations are safe in the area. While in *The Deceivers* Masters promotes a strong belief that it is the English who bring peace and security to the Indian roads and hamlets, and the vision of 'the English sahib as India's hero' (Morey 2000: 102), who is generally loved and admired, prevails in the novel, in *Nightrunners of Bengal* the novelist offers his interpretation of the events that destroyed the Company's ruling position.

Due to the success in combating the worshippers of Kali, William's son Rodney, whose birth ends the novel and who becomes the main protagonist in *Nightrunners of Bengal* (henceforth abbreviated as NB) can say proudly 30 years later that everywhere in India he is surrounded by 'symbols of the colossal empire of the Honourable East India Company' (NB 19). In its days it functioned as a tool of power exercised by the tiny center, England, over its vast periphery. A trading institution that in 1600 was started by George, Earl of Cumberland, and 215 Knights, Aldermen and Burgesses in the mid-1850s turned into a mighty instrument of British imperialism:

The company had become a weird blend of trading corporation and administrative engine, and the English government in London controlled it. It traded as it wished, and dictated treaties. It minted money, made laws, collected taxes, and executed criminal and civil justice. It kept the peace – and made war (...) The man who was its chief representative in India, the Governor-General, had direct and almost unlimited power over a hundred million people, and indirect power over other millions living in the states. ... [and] ... controlled three armies; (...) and together they numbered 38,000 British and 348,000 native troops, with 524 field guns. (NB 20)

Commenting on the Anglo-Indian relations of the first half of the 19th century from the current historical perspective Lawson summarizes the situation of the time in India as follows:

Much scholarship of the twentieth century that might be termed anti-colonialist or imperialist has seen this period of British rule through the Company as disastrous for the cause of progress in India. Actions like the introduction of English Common Law in many civil and criminal processes, the westernization of Indian education by means of English language instruction, and the outlawing of certain traditional Hindu practices, such as sati (widow-burning) and *thuggee* (ritualistic banditry), have been held responsible for creating severe divisions within native societies. Such divisions, in turn, halted the natural rise of India's economy and people to the position of a modern industrial state, as its producers served the markets of a distant colonial overlord rather than the nascent national interest. (Lawson 1993: 154)

Rodney Savage is devised to be a typical representative of his generation, a man with divided sympathies, who stays in India because he believes in the civilizing mission of the East India Company. The omniscient, extradiegetic narrator emphasizes the fact that being a descendant of the Savage family Rodney has a sense of historical continuity that makes him entirely identify with the policy of the Company:

Rodney had been born in and of that empire, but still it took his breath away when he considered the power created by those English merchants who had striven here and made themselves masters of princes. ... Today by luck and aggressive skill, by courage and persevering deceit, their footholds had so expanded that their Presidency of Bengal alone extended seventeen hundred miles from Burma to Afghanistan, and seven hundred miles from the Himalaya to the Nerbudda. (NB 19)

Yet, at the same time through Rodney Masters expresses his generation's criticism of the Company's policy in India in the 1850s, admitting that the pace of the changes introduced was too fast for Indians, who felt the English suddenly interfered too deeply into their customs and lifestyle. Rodney describes the current situation to his colleagues in the following analysis of the hostile attitudes prevailing among Indians:

And apart from these Army things they're affected by the same things which worry other Indians of their class and caste: suttee forbidden, female infanticide forbidden, Brahmins made subject to the criminal laws. We think those are good and just ideas, but the sepoys don't. They used to talk and try to understand our point of view; now they don't. (NB 114)

Such a tense situation must eventually lead to a disaster and the outbreak of the Indian Mutiny in 1857 destroys the 300-year-old tradition of good relations between the English and the Indians. Making discourse into history, Masters makes references to all the major historical events that occurred in the first half of 1857 in India. The linear storyline of the novel helps to build up the atmosphere of exotic mystery, growing slowly with every new event introduced. From Dec 31 1856 till May 10 1857 the impression of the pastoral tranquility, the English characters' sense of profound contentment and security is gradually flawed by some annoying events and premonitions that function as metaphorical harbingers of the approaching disaster.

The atrocities of the Mutiny destroy the old social order of the Anglo-Indian community and ruin the Company's privileged administrative position. As a result,

On 1 November 1858 Queen Victoria issued a proclamation that explicitly renounced 'the right and the desire to impose Our convictions on any of our subjects'. India was henceforth to be ruled not by the East India Company – it was to be wound up – but by the crown, represented by a Viceroy. (Fergusson 2004: 154)

The formal transition of the Company's interests to the state in 1858 brought to an end the most remarkable phase in Anglo-Indian history. The story of how this trading organization became an imperial power with its own armed forces is exceptional in its own right, but there are many more lessons still to be learned from the Company's unique past. In the general context of British history, the Company's role in the development of overseas trade, the advance of empire and the evolution of the modern bureaucratic state is now more broadly accepted and appreciated. In addition, the immense impact of the Company's activities at the centre of operations in London has at last begun to permeate the written texts and overviews dealing with these years of British expansion. More needs to be done, however, because the most striking and rewarding aspect of studying the East India Company's experience is that it confounds nationalist histories of one sort or another. (Lawson 1993: 164)

Conclusion

Although he is only a voice from the colonial periphery claimed neither by the Commonwealth Literature nor 'the literature of the centre' (Mishra and Hodge 1993: 276), Masters' contribution to modern literature written after 1947 is worth the reader's attention. Commenting on Masters' literary achievement Morey remarks that:

John Masters writes adventure stories of tremendous pace and energy which carry the reader along to an Invariably thunderous climax. However, his perspective and preoccupations lead him towards an unquestioning replication of imperial narrative forms in a post-imperial world. (Morey 2000:104).

Further, Morley observes that 'since Masters writes after independence' (Morey 2000: 101), his writing even involves 'a mythologizing of the imperial enterprise' (ibid.), and calls it 'an extended

act of imaginative recolonization, or of staying on' (ibid.), while Greenberger classifies him as one of the authors writing about India, who belong to The Era of Melancholy 1935-1960 (Greenberge 1969: 177-179), melancholy caused by a sense of loss of the British raj in India.

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REASONS FOR TREATING GLOBAL ECONOMIC JUSTICE AS AN ESSENTIALLY CONTESTABLE CONCEPT³⁵⁴

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Abstract:

Contemporary theorists in the fields of international relations and global business ethics are generally gloomy about the extensive cultural diversity that underlies radically different value systems and political norms worldwide. This diversity is tacitly regarded as the bane of efforts to internationalise criminal law and principles of corporate social responsibility [CSR]. In this essay it is proposed, to the contrary, that cultural diversity is best regarded as a vehicle for discovering fundamental convictions about the meaning of global justice rather than the main obstacle to its realisation. An alternative to Hobbesian classic liberal derision of international law is proposed here by relying upon indigenous models of good governance and diplomacy that prevail in the midst of contemporary West Africa's cultural diversity and economic distress. The possibility of global justice requires a conceptual change: from defining global justice as a fixed system of uniform procedures and implacable rules applied impartially and universally, to regarding the very idea of justice as essentially contestable (Alisdair MacIntyre 1973) emerging in a unique hybrid culture provoked by rigorous analytic confrontation between divergent traditions and contrary value systems. Since cultural diversity obtains within social hierarchies just as aggressively as it does across cultures, testimonies are required early in the process of treating global justice as an ongoing deliberative project, so that judicial interpreters come to know something about underclass experience and conditions prevailing in the expanding informal economic sector worldwide.

Keywords: Corporate social responsibility [CSR], Hobbes, international law, Thomas Nagel, West African political culture.

Introduction

A widely shared assumption is that ignominy and indecency in the global arena are incorrigible because cultural multiplicity poses a major obstacle to enforcing justice beyond national borders.³⁵⁵ Given the vigorous scope of cultural diversity, some influential philosophers regard moral

³⁵⁴ An ancestor of this essay was presented to the 2010 International Society for African Philosophy and Studies conference in Accra, Ghana, titled: "On the very idea of global justice and the role of African universities in its realisation." It was never published. Subsequent work was done thanks to an invitation to present a subsequent paper at Nnamdie Azikiew University for UNESCO World Philosophy Day, November 2011, Awka Nigeria, titled "Prospects for crafting global justice consensually: suggestions from models of indigenous African governance," also unpublished.

³⁵⁵ Samuel P. Huntington, "The Clash of Civilizations," *Foreign Affairs*. Summer. vol. 72, no. 2 (1993), pp. 22-28; Walker Connor, "Nation-Building or Nation-Destroying?" *World Politics* vol. 24, no. 3, (1972) pp. 319-355; Lawrence E. Harrison & Samuel P. Huntington, eds. *Culture Matters: How Values Shape Human Progress*, New York: Basic Books, 2000); Eric Zuelow, Book review of *Ethnonationalism in the Contemporary World: Walker Connor and the Study of Nationalism*. Daniele Conversi, ed., (New York: Routledge, 2002). <<http://www.nationalismproject.org/book>> Accessed October 2006.

relativism as defeating the very possibility of global justice, rendering the notion itself chimerical if not incoherent.³⁵⁶

To the contrary, I propose treating cultural diversity as a vehicle for discovering fundamental convictions about the meaning of global justice, rather than the main obstacle to its realisation. Contemporary West Africa is verily a festival of cultural diversity, and demands for international justice are raised and get addressed albeit inadequately on a daily basis. In , through traditional social and political structures, as will be discussed in this exploration of justice in an African social sense and its implications for a more humane and just global economic order. Varied as the West African situation is from country to country, one may take these conditions in some pertinent respects to be representative of conditions in post-colonial societies beyond the African continent. A brief exposure to the political history of West Africa's economies reveals that successful strategies for surviving crises with social dignity have been camouflaged from the purview of the international community. Contrary views about economic justice exist from within post colonial states at different levels of society. The sceptic who disparages international law as either unenforceable or logically nonsensical characterizes global justice as a magnification of the justice enforced within the boundaries of sovereign nation states.³⁵⁷ I propose treating global justice instead as an intercultural probe in progress³⁵⁸—not as a ubiquitous deterrent but as a promethean evolution of practices and precedents—always locally informed and interrogated from afar. Universal consent to a law's enforcement does not depend upon countenancing its author as an unassailable sovereign authority. Instead, political legitimacy is achieved in the global arena because each verdict is adopted as a working hypothesis, prescribed to undergo review systematically case by case through successive assessors' divergent cultural perspectives. On this view, the meaning of global justice is essentially contestable.³⁵⁹ And its feasibility results from making a fundamental *conceptual* change: from defining global justice as a fixed system of uniform procedures and implacable rules applied impartially worldwide, to regarding global justice as a unique hybrid culture that encourages insights provoked by rigorous analytic confrontation between divergent traditions and contrary value systems. An important corollary in this picture is that the dividing line between one cultural perspective and another is as much determined by economic circumstances as it is by geography and national boundaries.

To give some definite and immediate shape to such an amorphous vision, I restrict this discussion to the limited domain of international business ethics. This will be illuminating partly because allegations against multinational corporations [MNCs] have become so prevalent and varied in the last forty years that there has emerged an industry solely devoted to addressing such issues under the rubric 'corporate social responsibility' [CSR]. Narrowing this critique to international CSR managerial theories is not intended to determine whether in fact MNCs are ethically irresponsible or

³⁵⁶ Thomas Nagel, "The Problem of Global Justice," *Philosophy and Public Affairs* 33 (2005), pp. 113–147. Reprinted in *The Global Justice Reader*, ed. Thom Brooks, (Oxford: Blackwell, 2009), pp. 416-438. An example of this tacit scepticism shared by contemporary African intellectuals is found in A.G.A. Bello's remark, "... a world government, of whatever form, must therefore remain a dream or an ideal," p. 90 of his "Emmanuel Osigwe Anyiam-Osigwe on the Individual, the State and the World Order," *The Development Philosophy of Emmanuel Onyechere Osigwe Anyiam-Osigwe* vol. 2. eds. Olusegun Oladipo and Adebola Ekanola (2009), pp. 83-90.

³⁵⁷ Thomas Hobbes, *Leviathan* (1665).

³⁵⁸ The germ of this idea of depending upon a collective, gradual process for legitimating moral principles cross culturally, was first given to me with respect constructing a universal code of ethics for higher education, by my former Vice Chancellor, medical Professor Clifford Nii Boi Tagoe, in December 2009 when we were preparing his panel contributions to a roundtable discussion for the International Association of Universities, at their annual conference "Ethics and values in higher education in the era of globalization: what role for the disciplines?" Mykolis Romerus University, Vilnius, Lithuania, June 25-26, 2010.

³⁵⁹ Here as in the title, I am indebted to Alisdair MacIntyre, "The Essential Contestability of Some Social Concepts," *Ethics*, vol. 84, no.1 (1973), pp. 1-9.

whether and how they do perpetrate economic injustice globally as they are so often charged. Rather, I address the prior normative question of how it might be morally possible or politically legitimate³⁶⁰ to make such judgments.

Of course, it is one thing to wax operatically about the clarifying and motivating potential of well reasoned disputation across cultural divides. It is quite another thing to spell out what such an agenda for a forum of intercultural deliberation would actually entail. In this contribution I will aim only to show what it *cannot* entail. To this end, I review several ways in which the pursuit of global justice is reduced or conflated with other, arguably non-moral (commercial, political) agendas. In section one I highlight the contrast between affecting courteous diplomacy and meeting the stricter demands of ethical integrity in cross-cultural business contexts. In section two I address another deflation of global justice which confuses it with gains in economic growth, e.g. as measured by indicators spelled out in the UN Millennium Development Goals [MDGs].³⁶¹ In section three I review some received complaints that display why the international human rights covenants drawn up in the last fifty years fail to address demands for fairness and justice in world trade and in ‘aid for development’ policy analyses. Section four surveys features of good regional diplomacy and economic governance in West Africa that remain largely invisible outside the region—historically and politically. Arguably these are features which would nonetheless be essential in building an influential structure in the framework of international economic affairs, so that market values do not prevail exclusively in the global arena. In section five I will review in some detail an example of what can go wrong with a business administration model when this diversity of views is overlooked. The example suggests that the apparent callousness of MNC policies and practices abroad may be traced at least in part to sheer ignorance, not solely to disregard for ethical responsibilities in the global arena.

In conclusion, I will hope to have shown that an intercultural approach to pursuing global economic justice is essentially an ongoing project and would have to proceed in structurally distinct stages. This is because early in the process, testimonies are required so that deliberators come to know something about underclass experience and conditions prevailing in the informal economic sector. Beyond getting the facts straight, philosophical integration is crucial with respect to the diverse connotations and disputed referential extensions of key concepts, in order to get ethically intended praxis to meet its just purpose.

Business versus ethics

Sometimes ethical reasoning in the global economic arena has been conflated with efficient strategizing to mollify stakeholders while satiating shareholders. These are two important but distinct sorts of social enterprise. Of course they are closely tied up. As a matter of psychological fact, in all walks of our lives we seek out each other’s views and priorities to figure out what is the right thing to do. Very often, but not always, setting things right morally correlates with garnering social approval. Business corporations gain public approbation from the slightest exhibition of concern over ethical problems in the community where they are located. But it is elementary to recognise that the conscientious pursuit of social approval is one sort of concern; the commitment to create and implement a moral policy is quite another. Correlatively, although moral decision making in a multicultural setting very often entails maintenance of cross-cultural consensus, it is not wholly reducible to doing in Rome what the Romans do.

³⁶⁰ Thomas Nagel op. cit. (2005); see also John Rawls, *The Law of Peoples*, (Cambridge: Harvard University Press, 1999).

³⁶¹ Founder of the Earth Institute, Columbia University in New York and Director of the UN Millennium Project, Jeffrey Sachs presented the MDGs to the Secretary-General of the UN in 2005.

Yet as plain as this contrast may seem, several widely read business ethicists theorizing about transnational corporate social responsibility do not concur with this point.³⁶² Some scholars and practitioners assume—mistakenly, as I will argue—that it is the diversity of cultural expectations existing worldwide which is the primary obstacle to running a business honourably in cash-strapped economies.³⁶³ Husted and Allen claim, for instance, that “social responsibility is about stakeholder management; . . . it is about . . . achieving long term social objectives to create competitive advantage. [It] is about meeting agreed public expectations of [a] business firm’s behaviour; . . . it is a way of protecting the firm’s strategy from the social issues affecting the firm.”³⁶⁴ And “social responsiveness is [a firm’s] ability to respond to social pressures . . .”³⁶⁵ It would seem from the perspective of these business ethicists that practicing social responsibility across cultural borders involves chiefly unbiased reconciliation of conflicting preferences. Moon and Woolliams³⁶⁶ depict the practice of corporate social responsibility as requiring a kind of even dealing or impartial compliance with the divergent norms of relevant stakeholders and business operators with respect to their culturally specific styles of body language, dress codes, handshaking, voice modulation, gestures of deference, conflicting responses to moral puzzles, without fearing or favouring any alternative. Applying cross-cultural ethics in this light presumes that the chief virtue is one’s resolve to restrain from challenging or questioning or judging any point of view that registers as sufficiently popular on a suitably reputable opinion poll, such as Trompenaars’ data base.³⁶⁷

This advice conflates the domains of the empirical and the ethical. Consider a regional corporate manager who is obliged to work out an ethical solution to a practical problem, like deciding what minimum wage to fix in an impoverished economy, or how much of the company’s fiscal outlay to commit gratuitously to environmental protection measures. To adjudicate among her viable options, suppose she follows the advice of Moon and Woolliams³⁶⁸ by consulting the Trompenaars data base of 50,000 entries from one hundred countries which summarises statistically the majority response to ethical dilemmas concerning like matters on a national basis. She then recommends a policy commensurate with the dominant views tracked in the country where her franchises are based. She thus attunes her corporate policy to local opinion, or to what Moor and Woolliams call ‘the ethical environment’. But in so doing she has confused political correctness with moral conviction. The manager thus skirts the issue of what is the morally right thing to do and instead goes for what the traffic will allow. Like Kant’s honest tradesman who always gives the correct change to avoid alienating his customers,³⁶⁹ she is business savvy. By dodging the challenge of reasoning about the moral worth of public opinion, the regional manager may not have been culpable for doing anything morally wrong but neither is her action just or socially responsible in any robust ethical sense. She

³⁶² Over-generalisation is a core error in global discourse concerning African affairs. The case dependent arguments in this essay may not apply elsewhere than West Africa, although I assume close analogues might.

³⁶³ The view of cultural relativism as the key impediment to ethical transnational business practice is conveyed by William C. Frederick in “The Moral Authority of Transnational Corporate Codes,” *Journal of Business Ethics*, vol. 10 no. 3, May (1991), pp. 165-177; also in “From CSR₁ to CSR₂: The making of business-in-society thought,” *Business and Society*, vol. 33 (1994), pp. 150-164; by Bryan W. Husted and David B. Allen, “Is it ethical to use ethics as strategy?” *Journal of Business Ethics*, vol. 27 no.1/2, September (2000), pp. 21-31; Daniel Litvin, “Memo to the President: A Strategy for Business and Human Rights,” *Foreign Policy*, vol. 139, November/December (2003), pp. 68-72.

³⁶⁴ Bryan W. Husted and David B. Allen, “Corporate social strategy: toward a strategic approach to social issues in management,” Academy of Management Meeting, San Diego, California (1998), p 9; Husted and Allen, *ibid.* (2000), pp. 23-25.

³⁶⁵ Frederick, *ibid.* (1994), p. 154.

³⁶⁶ Chris J. Moon and P. Woolliams, “Managing Cross-cultural Business Ethics,” *Journal of Business Ethics*, vol. 27 no. 1/2, September (2000), pp. 105-115.

³⁶⁷ Moon and Woolliams, *ibid.* (2000), pp. 107, 113.

³⁶⁸ Frederick, *ibid.* (1991), p. 107.

³⁶⁹ The allusion here is to Immanuel Kant’s *Groundwork of a Metaphysics of Morals* (1785) first section, third paragraph.

may be exhibiting social *responsiveness* as Frederick defined it in 1994.³⁷⁰ But this seems to be a play on words. An opportunist who notices that everyone's focus is so keenly pinned on a televised football match that he can safely raid the till without being caught, could be called socially responsive in Frederick's sense.

A pseudo-philosophical problem should be dispensed with quickly and parenthetically here. Someone might be tempted to challenge the feasibility of any instrument to gauge something as elusive as social pressure in a cultural setting wholly alien to those who produced the instrument. But this specious worry may be just a variation of overlooking the essentially public and learnable nature of linguistic meaning, and it is readily cured with a quick dose of Quine's model of radical translation.³⁷¹ As Donald Davidson famously stressed,³⁷² there is a limit to how hopelessly uncertain we can consistently imagine ourselves to be when interpreting other creatures' signals or conversations while still regarding them as survival-oriented in their given situation as we understand it. That limit is exceeded if we insist upon speculating about a case where noise taken to be speech is so impenetrably foreign that we could not possibly fathom what its participants intend by it, nor what they might possibly believe or value about their specific situation which might have caused them to create those sounds. For by the same token, in that instance there would be nothing to prompt one interpretation for the sounds rather than another, nor indeed would there be anything to compel us to interpret the sounds as meaningful at all. We would likely regard such an apparition of speech just as we do any apparently random noise, as we normally do the sound of whispering that correlates with the sight of rustling leaves. In the more typical case, once we have sufficient evidence to regard a situation as a cultural context and noise as human speech, we are thereby supplied with the prompts required to begin conjecturing approximate meanings to the noise being made. And from our conjecture of sensible trains of thought—whether or not they accurately characterise the views of others—we can still gain insight about ourselves and the world by comparing and contrasting those breeds of belief, value, and intention with the more familiar interpretations that we claim as our own.

The real trouble with Trompenaars' database as a guide to ethical strategising³⁷³ is that it yields empirical facts about the choices made by questionnaire respondents, but it does no more than that. It does not reflect the moral propriety of those choices. It cannot. Arguably only a philosophically capable moral agent can perform this task; it is not an algorithmic problem. Suppose a computerized data base ingeniously avoids distilling the dissonance of a cross-cultural situation or of a complex society. The output of the data still would not yield a moral judgment. The fact that a practice is socially encouraged does not make it morally acceptable, even among the very people who condone it, covertly or overtly. Popular practice and moral rectitude on a given day may converge, or not, depending upon a host of circumstances. This is partly why there is a constant debate among constitutional law scholars about whether the jurists and legislators of government should try to educate, nudge, and propel their citizens to a more humane, more dignified law-abiding status quo than the one they inherited from their predecessors. The same challenge would preside in the global arena. If global justice were treated as a family resemblance term,³⁷⁴ its meaning could not be captured as simply the aggregate of all instances of its use. Its meaning would rather transform and grow in unpredictable ways through intercultural analytical debate.

³⁷⁰ Frederick, *ibid.* (1994), p. 154.

³⁷¹ Willard van Orman Quine, "On the reasons for indeterminacy of translation," *Journal of Philosophy*, vol 67, no. 6, March 26 (1970), pp. 178-183.

³⁷² Donald Davidson, "Radical Interpretation," *Dialectica* (1973) pp. 313-328. Reprinted in *Inquiries into Truth and Interpretation*, Oxford: Clarendon, 1984) pp. 125-139.

³⁷³ Moon and Woolliams, *op.cit.* (2000), p. 111.

³⁷⁴ I am invoking here Ludwig Wittgenstein's non-essentialist view of word meaning which uncontroversially applies to value terms; see his *Philosophical Investigations*, (New York: Macmillan, 1953) §66-§71.

For those investing in a country whose majority of citizens are undergoing economic difficulties, the question arises: to what extent should foreign fiscal players dominating a field in the private sector be acting as frontrunners of enlightened development? There may be much for CSR consultants to gain by drawing from reasoned disputation between divergent culture-specific perspectives, in order to embellish their own socially inherited views about moral decency and professional integrity, in formulating company options for contributing locally to the promotion of justice in world trade. If corporate managers working in disadvantaged economies are to face seriously the challenge of social and environmental responsibility, they must ask themselves normative questions about the impact of their company's profiteering in a foreign culture struggling with the pressures of extreme economic disarray. Styles of handshaking and dress codes *per se* hardly come into it.

Millennium Development Goals

Within the last decade, a standard answer to such questions has involved reliance upon the UN Millennium Development Goals, authored by Jeffrey Sachs.³⁷⁵ But apart from the surrealism of pegging their expiration date at 2015, the MDGs talk in numerical terms of minimum standards, foregoing the language of fundamental human rights or of humanitarian ideals.³⁷⁶ While number crunching results in analyses that are equally accessible across all international languages, by the same token, quantitative descriptions couched in any language are inadequate for making non-market value assessments.³⁷⁷ More profoundly, some of the mission statements expressed in the MDGs, if fulfilled, might actually exacerbate existing global economic inequities. For instance, MDG no. 8 mandates international partnerships between low income countries and the multinational corporate community, but does not require any legal apparatus to protect host countries against ruthless profiteering for which the MNC community has become notorious. The MDGs have been criticized by uncompromising economists because they adroitly bypass, for example, the needs of subsistence farmers in agrarian economies who are wholly responsible for feeding the majority of externally indebted populations.³⁷⁸ The MDGs do not address the need for African labour markets to be protected against foreign commandeered exploitation and degradation; nor do the MDGs address the need to control price fluctuation of imported goods; nor do they countenance the need to correct the anomalies created by subsidies and tariffs favouring only G-8 countries' producers and suppliers.³⁷⁹ Nor do the MDGs address the need to protect African manufacturers from monopolies inflicted by multinational conglomerates. The MDGs focus too simplistically on national aggregates and ignore the internal class-stratified variations in illiteracy, unemployment and poverty throughout national

³⁷⁵ Founder of the Earth Institute, Columbia University in New York and Director of the UN Millennium Project, Sachs presented the MDGs to the Secretary-General of the UN in 2005.

³⁷⁶ Political economist Frank Hormeku, of Third World Network-Africa, addressing NETRIGHT, April 2006, Teachers' Hall, Accra.

³⁷⁷ Michael Sandel discusses the importance of non-market values for assessing conditions in the global arena in his 2009 BBC Reith Lectures *A New Citizenship*. The Reith Lectures. Lecture 1: "Markets and Morals," June 9th transmission. BBC Radio 4. Transcript accessed August 10, 2010.

³⁷⁸ Millennium Development Goal 8 requires countries to establish "further an open, rule-based predictable, non-discriminatory trading and financial system. . . deal comprehensively with the debt problems . . . through national and international measures to make debt sustainable in the long term . . . make available the benefits of new technologies, especially ICT, in cooperation with the private sector." My emphasis.

³⁷⁹ A familiar example is the US and European cotton subsidies of US\$1 billion annually, artificially bloat world wide supply, undermining the more competitive high quality suppliers in Mali and Chad whose consequent net loss reaches US \$147 million annually, according to Fair Trade Report, released November 2010. BBC Worldservice *Network Africa* News, November 15, 2010.

territories. It has been argued that the correction of such regional imbalances is crucial to achieve sustainable economic growth.³⁸⁰

Human rights covenants

As an alternative to the MDGs, it is standard to consult the range of United Nations compacts and other world body documents for benchmarks and starting assumptions to establish codes for doing business in depressed economies.³⁸¹ The relevant institutions that appear to exist for encouraging respect for the UN treaties are the United Nations with its Declaration of Human Rights and its agencies in The Hague: the International Court of Justice which is the judiciary organ of the United Nations, and the International Criminal Court which was erected by a treaty established in 2002 called the Roman Statute. Since the jurisdiction of these bodies is not universally legitimated, their injunctions and proceedings can be, and have been, criticised as arbitrary and capricious. The principles of international law imply no rights and no obligations for third states that have not signed up to the Roman Statute, without that third party's consent.³⁸² They have no bearing whatsoever on the activities of MNCs which preside in the international arena under the protection of what is demarcated as 'the private domain'. Corporations are in some sense obliged by national legal instruments to respect the company laws of countries in which they do business. Yet ironically these UN covenants can still generate anomalies if one confuses the pursuit of ethical policy with the embrace of practices that are approved within a specific geographic region or trans-regional economic class. For example, from the little one can gather through reports issued by the UN Centre Against Apartheid in the 1980s, a prime example of such a *reductio ad absurdum* was the original Sullivan Principles, chartered in 1977 for American companies doing business in South Africa.³⁸³ The Sullivan Principles were the directives by which American corporations earned formal consent to operate in South Africa by maintaining the standards of social welfare officially condoned at the time. Americans built infrastructure that facilitated apartheid laws (i.e. miners' single-occupancy dormitories, Township housing, and the Bantu schools that ran at $\frac{1}{5}$ the cost of educating white Afrikaner children). Compliant American corporations assiduously abided by discriminatory labour regulations, until they were prohibited from doing so in 1994—i.e. the policy blatantly colluded with apartheid. Yet semantically, the Sullivan Principles were "entirely consistent with" the human rights covenants inscribed in the UN Declaration and the European Convention, the Helsinki Act, the OECD Guidelines for multinational enterprises, the ILO Tripartite Declaration, the UN Code of Trans National Corporate Conduct, to name just six such compacts.³⁸⁴

The case of the Sullivan Principles for doing business in apartheid South Africa illustrates the obvious fact that the private sector of the global arena does not compel in any way ethical business

³⁸⁰ Abena Oduro, "How adequate are the MDGs for the achievement of poverty reduction and development in Ghana?" *Reclaiming the Human Sciences and Humanities through African Perspectives*, eds. Helen Lauer and Kofi Anyidoho (Accra: SubSaharan Press, 2012), pp. 381-387.

³⁸¹ Richard Falk, "Human Rights," *Foreign Policy* vol. 141, March/April (2004), pp. 18-20, 22, 24, 26, 28; Frederick op.cit. (1991, 1994); Ralph Hamann, "Introduction," *The Journal of Corporate Citizenship*, vol. 28, December (2007), pp. 15-29; Michael Ignatieff, "The Attack on Human Rights," *Foreign Affairs*, vol. 80, no. 6, November-December (2001), pp. 102-116; Daniel Litvin, op.cit. (2003); Darryl Reed, "Corporate Governance Reforms in Developing Countries," *Journal Business Ethics*, vol. 37 (2002), p. 223-227; G.J. Rossouw, A. van der Watt, and D.P. Malan, "Corporate Governance in South Africa," *Journal of Business Ethics*, vol. 37, no. 3, May (2002), pp. 289-302.

³⁸² 1969 Vienna Convention on the Law of Treaties.

³⁸³ These remarks may bear no relation to the Global Sullivan Principles publicised in 1999, the content of which I have no idea. See "The Sullivan Principles: No Cure for Apartheid," UN Centre Against Apartheid Notes and Documents No. 16/80, issued May 1980. *Associated Press* May 12, 2008.

³⁸⁴ In 2008 apartheid victims were reported as suing 36 US corporations including Bank of America, Bristol Myers-Squibb, Colgate-Palmolive, Exxon Mobil, Hewlett Packard, IBM, Nestle, "for aiding in violations of international law," William C. Frederick, op.cit. (1991), p. 176 n. 1.

practices in regions that feature troubled and vulnerable national economies. As already noted, the international commercial norms which shape the global political economy are not binding by any formally enforceable, legal instruments.³⁸⁵ Yet the authority of multinational corporate elites is insuperable. International norms of trade are invincible only because they protect the movement and accumulation of privately commanded profits of investors who, financially, back among the most powerfully endowed military-industrial conglomerates—perhaps in the history of modern civilisation. Secondly, development consultants whose advice is promulgated internationally by the knowledge-distribution agencies of these same conglomerates, remain more or less oblivious to the cultural values and beliefs not already included in the global chorus of military and economic authorities. This is not for lack of their individual concern, ethical responsibility, diligence, or formal training. The absence of authoritative voices able to articulate first-hand experience of twentieth century economic injustices is an indication of the colonial legacy of modern political history,³⁸⁶ as I will try to show in the remainder of my remarks.

The invisibility of West Africa's indigenous political norms

The strengths of indigenous traditions of governance in Africa are largely invisible to the international gaze. Quite intentionally and without apology, there is much more to African governance and economic activity than may ever be permitted within the purview of international surveillance.³⁸⁷ Overlooking the inclusion of indigenous leaders in Ghana would severely handicap any forum convened to craft a policy of redress, reconciliation, or rehabilitation in response to a specific allegation of MNC injustice anywhere in the country. And yet the intercultural contexts as they are formally sustained by world bodies and regional consortia in West Africa typically do not include traditional leaders. Normally it is only the modern elite members of every region of Africa that are selected as representing their populaces at the level of global agency. Traditional institutions of governance are regarded summarily as ornamental relics of an ineffectual primordial past. It is modern elites who control proceedings in the public domain—including of course the international arena—so, wittingly or not they also monopolize the voice of authoritative experience taken into consideration in the process of conclusive decision making. Unless measures are taken to protect against it, standard methods of consensus and deliberation will discount procedurally the voices of authority operating at the social levels of genuinely conflicting interests.³⁸⁸ This is why some progressive activists advocating social and economic redress regard testimony *prior* to deliberations as key to the delivery of justice.³⁸⁹

³⁸⁵ Ann Claire Cutler, "Locating 'Authority' in the Global Political Economy," *International Studies Quarterly* vol. 43, no.1 (1999), pp. 59-81; Darryl Reed, op.cit. (2002), p. 240; Richard Falk op. cit. (2004), p. 22.

³⁸⁶ Claude Ake, *Democracy and Development in Africa*. (Ibadan: Spectrum Books, 2001; first edition Washington DC: The Brookings Institution, 1996).

³⁸⁷ These include sophisticated land distribution and family law, jurisprudence, social services including educational trusts, aid to the elderly, orphan aid, and holistic health care delivery, strict enforcement of environmental conservation policies. Helen Lauer, "Depreciating African Political Culture," *Journal of Black Studies* November vol. 38, no. 2 (2007), pp. 288-307.

³⁸⁸ Mark Lance, "Fetishizing Process," *Institute of Anarchist Studies*. (Washington DC: Georgetown University, 2005). Accessible online <<http://zinelibrary.info/files/Fetishizing%20Process.pdf>>.

³⁸⁹ Lynn Sanders op cit. (1997). I am grateful to Daniel H. Levine, Maryland School of Public Policy, for drawing my attention to the literature critiquing the elitism and hegemony prevalent in many consensus based systems. Quoting Levine in email correspondence: "the official denial of power is a mask for the operations of fairly rigid power hierarchies" which exclude those for whom access to juridical redress is denied systematically, University of Ghana, Legon November 2011. A similar concern is demonstrated in the abuses of land tenure rights committed in chieftaincy systems, decisively by Kojo Sebastian Amanor, "Custom, colonial ideology and privilege: the land question in Africa," *Reclaiming the Human Sciences and Humanities through African Perspectives*, eds. Helen Lauer and Kofi Anyidoho, (Accra: Sub Saharan Press, 2012) pp. 280-289. See also his "Custom, Community and Conflict: Neoliberalism, global market opportunity and local exclusion in the land question in Africa," presented to the International Symposium: *At the frontier of land issues: social embeddedness of rights and public policy* in Montpellier France, May 17-19 (2006). Accessed online November 2007: <http://www.mpl.ird.fr/colloque_foncier/Communications/PDF/Amanor%20TR.pdf>.

Elected officials in modern African democracies are regarded among the worst offenders in this respect of suppressing interests that might conflict with MNC profits. In response, modern states in Africa are perpetually subverted by the ordinary citizen on account of their geographic boundaries being anachronisms of former colonial intrusion, their inherited Western bureaucratic apparatus being sluggish and corrupt, their fiscal management policies being foreign imports, their compulsively distracted loyalties being monopolized by their dealings with greed motivated foreign venture capitalists. Africa's central states lose credibility insofar as they must deal with MNCs rather than confining their focus to custodianship of their citizens. Africa's modern state leaders lose credibility through the mandate they are obliged to fulfil by number eight of the Millennium Development Goals.³⁹⁰ It is contentious whether central state governments of post-Independence Africa are adequate to represent those sectors of their populations who are most often victimized or have most to lose by MNC policies in general or through the impact of particular initiatives (e.g. oil drilling in the Niger Delta, export of poultry and rice to markets in Ghana, mechanised trolling and dredge-fishing of Senegal's waters). Political philosophers are in dispute as to whether the problem of good representation in developing economies is rooted in the method of government composition via multi-party electoral politics.³⁹¹ Modern state structures make the ancestors furious³⁹² because in large measure successive governments in Africa have designed their commercial and tax laws, domestic labour policy, emigration procedures, and centralised public services to serve foreign capital interests.³⁹³ About this there is no dispute: central government agents in West Africa are compelled to act as reliable borrowers and accommodating business partners with MNCs in the global arena. For this priority they sacrifice their obligations to provide their constituents with social services (health care delivery, education, basic utilities, decent affordable housing, minimal wages). So the job of defining and fulfilling the stewardship duties of government most often falls to traditional authorities. Africans hold radically divergent views about their various systems of traditional authority, as to whether and how there should be integration of these indigenous governments into the central state apparatus of their constitutional republics and federations. This controversial aspect of African political culture and heritage requires the attention of international relations theorists who purport to advise Africans on the subject of good governance.

Since the 1980s the concern about good governance has been joined with concern over the fiscal management methods advised by the Bretton Woods institutions and the impacts of MNC activities in Africa. Some business management analysts argue that the current symptoms of organisational dysfunction faced in African corporations are historically rooted in centuries of euro-centric racism.³⁹⁴ The Deleuze specialist Martin Fuglsang regards the history of corporate business

³⁹⁰ It may be speculative but not wholly misguided to imagine that the remote, invincible and elusive power of General Motors and Exxon, Anglo-Ashanti Gold and Dutch Shell Oil Company today make roughly the same impression upon contemporary residents of West Africa as was imposed by the giant slave forts of Elmina, Cape Coast and Gore Island upon ordinary residents along this coast four hundred years ago.

³⁹¹ On the counterproductive effect of multi party electoral politics in African countries undergoing economic development see Kwasi Wiredu, "The State, Civil Society and Democracy in Africa," *Quest*, Special Issue: *State and Civil Society in Africa*, June, vol. 12, no. 1, (1998), pp. 240-252.

³⁹² Paraphrased from a quotation of Ali Mazrui, *The Africans: a triple heritage*. (London: BBC publishers, 1986) p. 11; featured by Damian Opata, p. 135 of "The beautiful interpreters are not yet here: the poverty of a metaphysics of state and civil society in Africa," *Quest* vol. 12, no. 1 (1998) Special issue: Proceedings of the international interdisciplinary colloquium: State and civil society in Africa, July 13-18, pp. 135-150.

³⁹³ Recently broadcast remarks of President Ellen Johnson-Sirleaf, if in earnest, suggest that Liberia may become a singular exception to the general rule within the next decade. *BBC*

³⁹⁴ Stefano Harney and Neeku Q. Nyathi, "Race, Revolution and Organization," *Philosophy and Organization*, eds. Campbell Jones and René ten Bos, (London: Routledge, 2007) pp. 133-142. These symptoms include disaffection, under-performance, factionalism, nepotism, deflection of resources, abuse of facilities, excessive turnover or stultification of personnel, disarray, aimlessness, *aporia*; see B. B. Pupilampu, "Toward a Framework for Understanding the Distressed Organization: Insights from Practitioner-Based

structures in Africa as indelibly linked to the “internal apparatus of capture in capitalism.”³⁹⁵ Even if such diabolical characterisations are taken to be figurative, some West Africans engaged in corporate ventures and related professions themselves remain unimpressed by these deconstructive styles of analysing African socio-economic history. They see such references to former colonial attitudes and practices as the direct causal determinants of today’s economic disorder as exaggerated and anachronistic.³⁹⁶ However, what the imagery does indicate, indisputably, is the growing disparity between the wealth and privilege prevailing in the formal economic sector on the one hand, and the grinding poverty sustained by a majority of West Africans subsisting in the agrarian, pastoral, and informal commercial sectors of their national economies. These two poles of experience in developing capitalist economies constitute either end of a continuum of diverging subcultures, the extremes of which grow evermore incommunicado in formal discursive contexts.

This emergence of radically divergent cultures as effects of class dynamics in West African perverted capitalist economies³⁹⁷ is not at all unique to the region; it may be seen as an effect of the ‘globalisation’ of capital expansion more generally observed. People in Accra and Lagos have more in common with New Yorkers and Londoners and residents of Delhi and Moscow today than they do with their compatriots in distant ‘rural’ regions of their own countries.³⁹⁸ This is evident not only in the way they live (the languages they speak, the clothes they wear and the food they eat), but in the diseases they contract, i.e. in the way they die. These cultural walls of silence building up alongside economic class divides in part sustains the global economic order by maintaining ignorance of important details about living conditions outside the formal sectors of national economies in transition. So it is in West Africa, that the degree to which social despair has been alleviated by the royal lineages and their ancient systems of governance remains vigorously disputed among intellectuals and culture spokesmen occupying different class strata.³⁹⁹ Yet there is no gainsaying that modern state structures have been regarded as unfortunate perversions of governance in the collective West African experience for over half a millennium. So it is a commonplace, as much among street-sellers as company board members, to be cynical about the adage that elected politicians are employed to meet the concerns and needs of their constituents. For it is hard to dispute such cynicism in countries where a large sector of citizens do not speak any language in common with the members of parliament for whom they count as constituents. A widely held perception in West Africa is that the domain of electoral politics is a field akin to commercial business where success is measured with impunity by the accrual of personal wealth.

It needs to be stressed that the conflicts arising between local community activists resisting the intrusion of MNCs and their in-country agents are not due solely to contemporary *perceptions* and *attitudes* towards foreign business based on collective memory of trans-Atlantic trade. The conflict over oil drilling in the Niger Delta is an illustrative case in point.⁴⁰⁰ Contrary to the perspective

Organizational Interventions in an Emerging Economy,” *Consulting Psychology Journal: Practice and Research*, Fall vol. 57 no. 4, Fall (2005) pp. 246-258.

³⁹⁵ Martin Fuglsang, “Critique and resistance: on the necessity of organizational philosophy,” *Philosophy and Organization*, eds. Campbell Jones and René ten Bos, (London: Routledge, 2007) pp. 133-142.

³⁹⁶ I owe this point to A.T. Konu, retired Registrar of the University of Ghana, Legon, in conversation November 2011.

³⁹⁷ Samir Amin, “The use of false concepts in the conventional discourse on Africa. (Is Africa really marginalised?)” in *History and Philosophy of Science for African Undergraduates*, ed. Helen Lauer (Ibadan: Hope Publications, 2003), pp. 130-135.

³⁹⁸ Helen Lauer, “Depreciating African Political Culture,” *Journal of Black Studies* vol. 38, no. 2 November (2007), pp. 288-307.

³⁹⁹ Lecture/Seminar series of the Institute for Democratic Governance (IDEG) in 2007. Tribe vs. Nation. See also Kojo S. Amanor, op.cit. (2006, 2012).

⁴⁰⁰ There is a voluminous literature documenting the negative impacts of MNCs in Africa; well known popularizations include Walden Bello’s *Deglobalization*. (London: Zed, 2004); Joseph E. Stiglitz, *Globalization and Its Discontents*, (New York: Norton, 2002); and William K. Tabb, *Unequal Partners: A Primer on Globalization* (New York: New Press, 2002).

learned by corporate executive guidelines for managing public relations,⁴⁰¹ one might argue that it is chiefly the *actual* legacies left by international trade and commerce agencies themselves throughout history that contribute to the ethical problems encountered for foreign business investors today. These problems cannot be addressed without more information and awareness exchanged between stakeholders at all levels of West African economic development. To consider further the evidence of vertically drawn cultural divides: at a wider geographical level, the political organs aimed at regional integration formed by West Africa's central state bodies are comparably criticised for being out of touch with the populations whose interests they are supposed to protect in the global economic arena. In 2003 a Nigerian critic of ECOWAS observed that "a major flaw [of ECOWAS] is the absence of popular support and participation [and this is] . . . typical of most modern Africa's regional and sub-regional integration projects."⁴⁰² These cases indicate that breaches of communication about economic injustice in Africa can easily be oversimplified as a matter of insiders not divulging facts of the matter to the continent's outsiders. As observed, 'vertical' interclass disaffection significantly stymies vital flows of information as well.⁴⁰³

Yet any intercultural exchange within and between nation states must take place in the public domain of one cultural space or another. This suggests that in order to facilitate global justice as the outcome of intercultural confrontation, it must be orchestrated stage by stage. Early in the proceedings, attention must be focused upon narratives, anecdotes and personal accounts of local problems from individuals in the uncelebrated non-elite sectors of both national and global hierarchies. Nor is it just empirical data which needs gathering to develop moral policies that will be recognised as legitimate interculturally—both within and beyond national borders. Recognising and grappling with conceptual contrasts may prove to be just as essential for meeting the moral demands and practical challenges of global justice that international MNCs encounter.

Consider the very notion of justice itself. In much of West Africa, when two or more parties in a primordial public are in conflict, they seek a neutral party to mediate. If this fails, a formal hearing is sought in an established legal structure, presided over by a recognized authority who might be a traditional leader i.e. a royal in the village whose equanimity is respected. When called on to resolve the conflict, this assessor is not expected to establish which party is the winner and which the loser. Judicial process is not a competition according to traditional African political culture. Justice in this system is not served by determining who is legally right and who is wrong. Rather, conflict resolution through these procedures is the "restoration of an equilibrium that previously prevailed

⁴⁰¹ According to Ed Nusbaum, the CEO of Grant Thornton International, ". . . key factors driving businesses globally towards more ethical business practices are a desire to keep costs down, to build brand and to secure staff, indicates the way in which corporate social responsibility (CSR) activity penetrates many areas of a business's operations. It also suggests that how a business is perceived is now as important as how CSR practices impact on the bottom line." *Corporate Social Responsibility: the power of perception*, Grant Thornton International Business Report (2011), p.2 Accessed January 10, 2012 <<http://www.granthornton.co.nz/Assets/documents/pubSeminars/IBR-2011-CSR-Report.pdf>>

⁴⁰² A. I. Asinwaju, "The implementation of ECOWAS treaty protocols," p. 715 in *Ghana and Africa in the World Essays in Honor of Adu Boahen*, (ed) Toyin Falola, (Trenton, New Jersey: Africa World Press, 2003), pp. 715-729.

⁴⁰³ In Ghana significant class divides rooted in educational opportunity continue today to reflect the disparities in social service created by British colonial rule who invested institutions, goods and services to the southern coast where foreign trade and administrative centres were located, disregarding the three northern regions and forest belt regions of the country as inconsequential. This is well established as a key contributor to lasting inequities in Ghana's economic development. See Ivan Addae-Mensah, *Education in Ghana: A tool for social mobility or social stratification?* J.B. Danquah Memorial Lectures (Accra: Ghana Academy of Arts and Sciences, April 2000); and Jacob Songso, "Population Growth and Ecological Degradation in Northern Ghana: the Complex Reality," in *Ghana: Changing Values / Changing Technologies*, edited by Helen Lauer, (Washington DC: Council for Research in Values and Philosophy, 2000), accessible online at <<http://www.crvp.org/book/Series02/II-5/contents.htm>>; also the point is evidenced and expanded fully in his *Regional development in Ghana: the theory and the reality*, (Accra: Woeli Publishing, 2003).

before the conflict arose.”⁴⁰⁴ This contrast between meanings of justice and expectations of what its administration should deliver, is just one example of the many that might emerge in a rigorous deliberation about how to define and deliver solutions to the crises riddling the economic landscapes of West Africa’s modernity. So it appears that without allowing individuals from different economic and social strata to explain the local problems they face and perceive as impacts of large scale business from their own points of view, efforts at corporate-driven reconciliation and reparation will be uninformed and possibly futile.⁴⁰⁵ Business management theorists speculating on solutions to social and economic development problems can go seriously awry, for lack of exposure to the conditions and the value orientations of those whose claims of injustice they wish to address. I give one entertaining example of this kind of breakdown of theory below.

Intercultural blind spots

A widely received domestic concern emerging in West African corporate sectors is the entitlement to quality work. Business management specialists Norman Jackson and Pippa Carter⁴⁰⁶ propose a diagnosis for the structural causes and attitudinal factors compelling habitual overwork of waged employees. They propose a universal prescription based on the contrast between “work in itself” (which may be self-determined) vs. “imposed work” (salaried labour).⁴⁰⁷ But they seem unaware that their depiction is limited to the atypical conditions of wage labour in late-capitalist welfare states. Consequently their proposal of “labor extensification” for solving the stresses of overwork⁴⁰⁸ is wholly inappropriate advice for subsistence agrarian economies. The extensional incongruence of ‘workload’ as defined in the two cultural contexts is so great that what is meant to be a lighthearted analysis is virtually offensive in its irrelevancy to the “workers of the world.” For example in Ghana often the only alternative to keeping too busy to have *time* to eat, is the option of having nothing *to* eat. In most faltering economies of Africa, overwork is unrecognizable as any deviation from the norm. Background material conditions add significantly to the intrinsic pressures of a particular business operation’s disorganisation. For instance one deleterious effect of inadequate road networks is their impact upon the nutritional intake of the children whose parents belong to the wage earning professional class in Ghana, who are further constrained, not relieved, by the supplementary “not work” of commuting. This aspect of extra curricular work-related stress would go wholly unnoticed on the Jackson and Carter model. Many families with two high wage earners are in traffic on average four to six hours each day. Nine percent of their primary school age children have measurably stunted growth because they are undernourished, due to negligence of house help or the notorious ‘meals on wheels’ syndrome that plagues so many middle class families commuting in and out of Accra and its luxury suburbs.⁴⁰⁹ A perverted capitalist system prevents some people from doing any salaried work at all and others from doing nothing but work. For civil servants on a lower rung of the informal sector, two or three jobs in Greater Accra attract an income that meets the cost of public transport to the workplace.

⁴⁰⁴ I am grateful to Professor Divine Amenumey, History Department, University of Cape Coast, Ghana, for this succinct account. See Helen Lauer, op cit. (2007) p. 302.

⁴⁰⁵ This has been well documented in the Women in Development literature since the 1980s. See the excellent, seminal compendium by Patricia Stamp, *Technology, Gender and Power in Africa*, (Ottawa: International Development Research Centre IDRC, 1989).

⁴⁰⁶ Norman Jackson and Pippa Carter, “Workers of the world . . . relax! Introducing a philosophy of idleness to organization studies,” in *Philosophy and Organization*, eds. Campbell Jones and René ten Bos, (London: Routledge, 2007a), pp. 143-156. For more of the same see their *Rethinking Organisational Behaviour: a poststructuralist framework*, (New Jersey: Prentice Hall, 2007b).

⁴⁰⁷ Jackson and Carter, *ibid.* (2007a) p. 153.

⁴⁰⁸ Jackson and Carter, op cit. (2007a) p. 150.

⁴⁰⁹ Delali Badasu studied the phenomenon in Ghana during 1998 of severe stunting due to malnourishment. She observed in as many as 9% of children in a cross section of all the economic classes that were studied, not just the lowest income families. Stunting occurred in high income groups of middle and upper income suburbs of Accra where working parents carry children in automobiles before and after working hours, or leave their children responsible for their own food intake or dependent upon low income house-helpers who are often themselves hungry older children; see her “Urban Households Coping with Child Care,” Paper delivered to the *3rd Annual Conference Historical Society of Ghana: Tradition and Modernity in Ghanaian Urbanisation*, July 17th (2004) University of Ghana, Legon. Also for statistics of cross-class malnourishment see *Situational Analysis 2000*, Ghana Report for ISSER and UNICEF, p. 41.

Contrasting starkly with Jackson and Carter's thesis, the causes behind dysfunctional stresses of overworking in Ghana cannot be relegated to theological principles (like the Protestant work ethic) or to individuals' acquired personality disorders (like misplaced loyalty or dislocated identity). No-tech households require that most work is conducted outside the formal sector and outside office hours. So the prescriptive contrast which Jackson and Carter draw⁴¹⁰ is inadequate to capture the conditions in subsistence agrarian economies. In Ghana the majority of children are engaged in "work in itself" as defined by Carter and Jackson, for they are not earning a regular wage. But they will never join a viable workforce since they are woefully stuck in "not-work" activity and denied what for them would be a privilege, of being restricted to the "imposed work" schedule of daily school attendance or a trade apprenticeship. Most children lucky enough to attend school must engage in petty labour ("not work") for four to six hours a day to help bring food to their families and manage their own school fees.⁴¹¹ Thus the "not work" that Jackson and Carter encourage can exacerbate the problems they purport to solve. For instance on the pretext that most labour in Ghana is non-salaried without any traceable fixed income, the statistical services unit in Ghana's Ministry of Finance and Economic Planning is under no obligation to maintain a national unemployment index.⁴¹² And to comply with World Bank dictates (which are fashioned on the basis of reports and cutting edge "poststructuralist" advice that consultants like Jackson and Carter produce) the government of Ghana recently encouraged new college graduates to find their feet in 'private entrepreneurial' activities instead of seeking salaried jobs in formal corporate structures. The negative implications for tax revenue collection and other knock on effects of a bloated informal sector of fragile economies lie beyond the scope of many analysts in development economics who romanticize self-reliance as if it were the driving motivation behind joining the vast majority in non-wage commercial and agrarian subsistence labour.⁴¹³ As it manifests in Ghana's bloated informal sector, Jackson and Carter's "not-work" solution is an orchestrated institutionalization of mass unemployment. To call this an improvement over the stresses imposed by the salaried job sector is at best a nasty joke.

In order to humanize management policy, Jackson and Carter further recommend upgrading our regard for *human* resources as we now do our *natural* resources. They assume that this approach will inspire a tidy transfer of environmental ethics, principles of ecological cultivation, environmental protection and resource preservation, to the domain of manpower.⁴¹⁴ This brainstorm is particularly repugnant in a postcolonial society where the Victorian legacy of viewing human populations as extensions of local flora and fauna still lingers like a depressing stench over labour management policy. Carter and Jackson ultimately appeal for legitimacy to Bertrand Russell's famous essay, "In Praise of Idleness."⁴¹⁵ But reflections about the meaning of life posed by an icon of the privileged aristocratic English gentry do not help to confront the consequences of perpetuating today's global division of labour, even if those reflections have an elegant socialist flavour. The fundamental questions that Ghanaian CSR consultants need to face do not concern what it *means* to be human so much as *who* is to be counted and *treated* as human. And correlatively, contrary to the claim of these theorists, "the future direction of organisation studies" depends not upon *whether* philosophical questions regarding overwork will be asked, but rather *which* philosophical questions will be asked. This correction cannot occur without continual intercultural checks on the connotation of words in use and the local conditions in which they refer.

⁴¹⁰ Jackson and Carter, op cit. (2007a), p. 153.

⁴¹¹ See Judith S. Sawyerr's reports on public schools in Ga West (completed in December 2005) and in Dangme West Districts of Greater Accra (completed in October 2006) commissioned by the Greater Accra Branch of the Ghana National Education Campaign Coalition (GNECC). Also see her "Failures in the Provision of Free Public Basic Education in Ghana," in *Tinabantu (Journal of African National Affairs)* vol. 2, no. 2, August (2006).

⁴¹² Dr. Anthony Tsekpo, Senior Research Fellow of ISSER, University of Ghana Legon and member of the Tripartite Committee of the Ministry of Finance and Economic Planning, in conversation, June 2006.

⁴¹³ See for instance Kwame A. Ninsin's correctives of Naomi Chazan's romanticised theory of self employment in the informal sector, "Informalization and Ghanaian Politics," *Ghana: Changing Values / Changing Technologies* ed. H. Lauer, Washington DC: Council for Research in Values and Philosophy (2000). Online at <<http://www.crvp.org/book/Series02/II-5/contents.htm>>]

⁴¹⁴ Jackson and Carter, op.cit. (2007a); see also David Dawson, "Applying stories of the environment to business," *Journal of Business Ethics*, vol. 58 no. 1/3, April-May (2005), pp. 37-49.

⁴¹⁵ Bertrand Russell "In praise of idleness," (1932) *In Praise of Idleness and Other Essays*, (New York: W.W. Norton & Co, 1935).

Conclusion

The considerations canvassed here suggest that a major obstacle to addressing the problems regarded as injustice in fragile economies is the ignorance that obtains between cultures. We noted that the cultural boundaries inhibiting such vital knowledge obtain both vertically and horizontally: cultural contrasts that obscure a workable notion of global economic injustice are determined by economic and social class divides within a nation as well as by the geographic and historical divides between nations. Perhaps because the political elites of modernity play such a critical role in the dissemination of knowledge internationally, domestic facts about people coping with severe economic inequities and social hardships in African nation-states remain largely opaque to G-8 country leaders and to the multinational business experts whom they consult. Speculations of how one would apply principles of corporate social responsibility internationally to alleviate these injustices are likely to fall short of their purpose. So it is crucial that advocates of global justice critically engage with the heirs of indigenous political culture whose voices are typically overlooked in official assemblies of modern global discourse.⁴¹⁶ It appears that testimony is uneliminable in any intercultural process of formulating what economic justice would mean in those regions most urgently demanding its delivery. Because of this requirement, the search for a workable definition of global justice is best served by treating it as an open textured concept whose connotations are necessarily local and culturally dependent, clarified, deepened, and changing over time, through intercultural contestation and interrogation. The very structure of ethical reasoning itself might provide *a priori* reasons for expecting that intercultural disputation will be a source of moral insight without needing to speculate the existence of cultural universals. I have yet to analyse the potential of normative disagreement in this light.

⁴¹⁶ Lynn Sanders counsels the importance of testimony in democratic process in "Against Deliberation," *Political Theory*, June, vol. 25 no.3 (1997), pp. 347-377. So do Iris Marion Young, "Activist challenges to deliberative democracy," *Political Theory*, vol. 29 no.5, 2001, pp. 670-690; and Archon Fung, "Deliberation before the revolution," *Political Theory*, vol. 33 no.2 (2005), pp. 397-419.

REGIMES AUTORITÁRIOS EM ÁFRICA: O CASO DA GUINÉ EQUATORIAL

Rodrigo Vaz

Abstract:

Authoritarian regimes formed a big part of the African political landscape for several decades since African countries got their independence. With the third wave of democratization, that landscape began to suffer some changes and several authoritarian regimes became hybrid or even democratic ones. However, some countries kept their authoritarian regimes as closed and repressive as before. Equatorial Guinea is one of those cases. This essay aims at, after analysing a wide range of academic literature on authoritarian regimes, understand how – and why – Equatorial Guinea kept the same authoritarian regime, with a transition to an hybrid or even a democratic regime not in sight for the near future.

Key Words: Authoritarian regimes, Africa, politics

Resumo

Os regimes autoritários constituíram uma grande parte da paisagem política de África durante largas décadas, desde que os países africanos foram conquistando a independência. Com a terceira onda de democratização, essa paisagem começou a mudar e muitos regimes autoritários passaram a regimes híbridos ou, até, a democracias. No entanto, alguns – poucos – países conservaram regimes autocráticos fechados, com os mesmos níveis de repressão de antes. A Guiné Equatorial é um desses regimes. Este ensaio pretende, depois de analisar um campo vasto da literatura sobre regimes autoritários e as suas causas e consequências, perceber como – e porquê – a Guiné Equatorial manteve o mesmo regime autoritário, sem sinais de sofrer uma transição para um regime híbrido ou até democrático no futuro próximo.

*Be brief, we have to do in decades what Europe achieved in centuries.
Poster num escritório governamental nos Camarões em 1971*

*The problem is not so much that development [in Africa] as failed as
it was never really on the agenda in the first place.*

Claude Ake

*State radio in Equatorial Guinea reported on July 16, 2003, that President Nguema is in permanent
contact with the Almighty and that he can decide to kill without anyone being able to hold him
accountable and without him going to Hell.*

Goran Hyden

Estado da Arte

Desde que os primeiros países africanos conseguiram a independência, a sua história tem sido marcada por uma acentuada instabilidade política, com vários golpes de estado, governos de juntas militares e ditaduras de um só partido a assombrarem a instauração de regimes democráticos no continente. Segundo a Freedom House, em 1973 (data da primeira publicação da *Freedom of the World*) 70% dos regimes políticos da África subsariana eram considerados como não-livres, em contraste com a percentagem global de 43% no mesmo ano.

Em função disso, muito tem sido escrito sobre regimes autoritários⁴¹⁷. Collier e Levitsky (1997) referem que, como resultado da terceira vaga de democratização, proliferaram os regimes que não são nem democráticos nem completamente autoritários e referem a emergência de regimes híbridos, que intitulam de “democracias com adjetivos”. No mesmo sentido, Bogaards (2009) regista um aspecto que já vem sendo tratado por outros académicos (Diamond, 2002) e aponta cinco tipos de regime: democracia funcional, democracia defectiva, autoritarismo eleitoral, autoritarismo fechado e totalitarismo.

Hadenius e Teorell (2006), num estudo extensivo sobre diferentes tipos de autoritarismo, concluem que o regime autoritário mais propenso a uma transição para a democracia é o regime autoritário multipartidário limitado, o que, como os próprios autores indicam, não é surpreendente visto que este obriga a um nível mínimo de abertura e contestação de liberdade política, mesmo que rudimentar. Estas conclusões vão ao encontro das conclusões de outros autores como Bratton e van der Walle (1997), quando estes referem que a transição para a democracia é muito mais facilitada num regime autoritário em que a competição é, ainda que de modo frágil, permitida. Ainda relacionada com as razões que levam alguns regimes autoritários a serem mais resistentes à mudança que outros, encontramos a análise de Gandhi e Przeworski (2007) que, sobre a resiliência de alguns autocratas no poder assinalam a importância das instituições políticas. Como Gandhi e Przeworski explicam, em situações de necessidade, os líderes destes regimes autoritários vêm-se na necessidade de se apoiarem numa instituição que lhes garanta algum suporte, seja um partido capaz de mobilizar apoio popular, um Parlamento que inclua alguns membros da oposição ou, até, um regime que permita vários partidos, embora, como já vimos com Hadenius e Teorell (2006), esta última solução possa já mais facilmente servir de ponte transitória para um regime democrático. No mesmo sentido, também Geddes (2006) estudou as funções dos partidos e das eleições em regimes autoritários, que fazem da presença destes elementos mais do que uma simples homenagem do vício à virtude.

Outros estudos focam-se na relação entre autoritarismo e crescimento económico. Um dos aspectos mais interessantes da literatura sobre este capítulo é a constatação de que estudos sobre regimes políticos e crescimento económico de há algumas décadas atrás eram mais complacentes com regimes autoritários do que estudos mais actuais. Dick (1974), num estudo sobre a questão de regimes autoritários serem ou não mais adequados ao crescimento económico, cita Bhagwati (1966), com este último a afirmar que os estados subdesenvolvidos enfrentam uma escolha cruel entre crescimento económico rápido e o processo democrático. No entanto, esta visão está ultrapassada: em estudos actuais, como o de Harber (2002), é defendido que os regimes autoritários atrasaram o crescimento económico devido a seis principais razões: em primeiro lugar, o autoritarismo é propício ao florescer da corrupção; em segundo, é marcado pela violência e pelo eclodir de guerras civis e conflitos; em terceiro lugar, no caso dos regimes autoritários comandados por militares (mas não só), faz com que os gastos com o sector da defesa ocupem grande parte da despesa do estado. Em quarto lugar, os regimes autoritários criam, ainda, um clima de intimidação e repressão, o que anula o debate sobre possíveis soluções para o problema do subdesenvolvimento. O papel das elites explica os dois últimos

⁴¹⁷ Apesar de, como refere Smith (2005), com a queda dos regimes democráticos na América Latina na década de 1970, mais ter sido escrito sobre transições para a democracia, visto que para os académicos os regimes autoritários foram perdendo interesse.

factores: para além dos problemas da população serem muitas vezes ignorados pelas elites que comandam os regimes autoritários, estas elites são, muitas vezes, urbanas. Ora, segundo Harber, porque a maioria da população africana vive em áreas rurais, um regime democrático faria transparecer esta realidade na composição das elites governativas; numa ditadura, no entanto, as elites não se preocuparão com estes problemas. Outros artigos salientam a relação entre mudanças de regime e níveis de riqueza ou crises económicas: Jensen e Watchekon (2004) concluem que entre 1975 e 1990, os países ricos em recursos naturais tenderam a ter regimes mais autoritários, bem como maiores níveis de corrupção. Uma conclusão semelhante é apresentada por Smith (2004), ao afirmar que os países exportadores de petróleo são menos propensos a mudar de regime.

O continente africano, como já referimos, conheceu em vários dos seus países longas experiências autoritárias. Como recorda Young (2010), nenhum governo mudou de mãos através de eleições até 1991. Meredith (2005) acrescenta que quando o senegalês Abdou Diouf aceitou a sua derrota eleitoral e cedeu o lugar a Abdoulaye Wade em 2000, foi apenas o quarto presidente africano a fazê-lo. Uma explicação avançada por vários autores, entre os quais Ake (1996), que atribui a instalação de regimes autoritários a uma retórica de desenvolvimento que exigia que, para atingir rapidamente o progresso económico, não poderia haver divergências a nível político. Este discurso de desenvolvimento, como Ake (1996) aponta, teve como modelo o desenvolvimento ocidental – como o autor refere, “*African leaders (...) argued that now that independence had been won, the overriding task was development, without which political independence could not be consolidated*”. Young (2010) alude a um elemento que corrobora esta tese. Ao referir a visita do antropólogo holandês Peter Geschiere a uma aldeia nos Camarões, em 1971, conta que este encontrou num escritório governamental um poster que dizia “*Be brief, we have to do in decades what Europe achieved in centuries*”. Como explica Young (2010), muitos estados africanos instituíram um regime autoritário de partido único, justificado pela necessidade urgente de crescimento e progresso económicos⁴¹⁸.

Neste ensaio iremos abordar o regime autoritário da Guiné Equatorial. O continente africano conheceu vários regimes autoritários desde que os seus estados se tornaram independentes. No entanto, a partir de 1989, a onda iniciada pela queda do muro de Berlim e da URSS provocou também o fim de alguns regimes autoritários africanos (Bratton, 1997). Nem todos estes regimes se transformaram em regimes de democracia multipartidária, mas, na sua grande maioria, tornaram-se no mínimo nos regimes híbridos referidos acima (Diamond, 2002; Bogaards, 2009): segundo a Freedom House, em 1988, 32 países africanos eram considerados não-livres, o que corresponde a 70% do total; em 1994, eram 23 (48%). O número de regimes considerados livres quadruplicou: de 2 (4%) em 1988, passou para 8 (17%) em 1994. Os regimes parcialmente livres, que eram 12 (26%) em 1988, passaram a ser 17 (35%) em 1994. A Guiné Equatorial manteve-se, no entanto, como um regime autoritário, que conserva desde 1973 (data da primeira análise da *Freedom House*) um *rating* que varia entre o 6 e o 7⁴¹⁹. Depois de fazermos um breve contextualização histórico-política do país, analisaremos o sistema político e o respeito pelas liberdades políticas e civis da Guiné Equatorial.

Case Study: Guiné Equatorial

Enquadramento histórico-político

A Guiné Equatorial tornou-se independente de Espanha em 1968. O seu primeiro presidente foi Francisco Macías Nguema. Com um discurso fortemente anti-espanhol, a grande maioria da população espanhola de 7000 pessoas, que tinha optado por ficar na Guiné Equatorial, saiu do país até Março de 1969. Nguema embarcou, então, numa espiral de violência que só terminou com a execução de 10 dos 12 ministros do seu primeiro governo. Muito mais expressivo da violência no país é o facto

⁴¹⁸“*If the over whelming challenge was to ‘develop’, political opposition was a luxury the new states could illafford*” (Young, 2010, p. 59)

⁴¹⁹Numa escala em que 1 corresponde ao nível mais livre e 7 ao menos livre.

de, numa população de 300 000 pessoas, pelo menos 50 000 terem sido executadas e 125 000 procurado exilar-se (Meredith, 2005). Economicamente, o país estava de rastos: os ministérios não tinham qualquer orçamento e simplesmente encerraram os seus escritórios na capital, Malabo; em 1976, o banco central foi também encerrado e o seu director executado publicamente.

A 3 de Agosto de 1979, o sobrinho de Macías, o coronel Teodoro Obiang Nguema Mbasogo, que era já comandante da Guarda Nacional e director nacional do sistema prisional, levou a cabo um golpe de estado e afastou o tio do poder. Francisco Macías Nguema foi julgado num cinema, em Malabo, em Setembro de 1979 e executado.

O coronel Obiang manteve, no entanto, os altos níveis de repressão política no país. Em 1991, sob pressão internacional, instaurou um regime multipartidário, mas os números das várias eleições que se realizaram desde então são considerados fraudulentos pelos observadores internacionais, com o Partido Democrático da Guiné Equatorial (PDGE) de Obiang a ganhar todas as eleições, apresentando resultados entre os 95 e os 100 por cento⁴²⁰ (segundo dados da *African Elections Database*), em coligação que juntou outros 9 pequenos partidos.

Sistema Político e Eleitoral

A Guiné Equatorial é uma República Presidencial. O poder executivo cabe ao Presidente, que é o Chefe de Estado e que tem a seu cargo a nomeação do Primeiro-Ministro. O Presidente é eleito para mandatos de 7 anos, renováveis ilimitadamente, por sistema maioritário. O poder legislativo é da responsabilidade da Câmara dos Representantes do Povo, eleita por mandatos de cinco anos⁴²¹, enquanto o poder judicial é assegurado pelo Supremo Tribunal, cujos membros são nomeados e removidos pelo Presidente.

Respeito pelos direitos políticos e liberdades civis

Ano	Direitos Políticos	Liberdades Civis	Conclusão
1975	6	7	NF
1980	7	6	NF
1985	7	7	NF
1990	7	7	NF
1995	7	7	NF
2000	7	7	NF
2005	7	6	NF
2010	7	7	NF

Fonte: Freedom House⁴²²

Os valores da tabela supra traduzem e comprovam o explicado no contexto histórico-político já apresentado. A Guiné Equatorial tem um regime que não respeita os direitos políticos e as

⁴²⁰As mais recentes foram as eleições legislativas e municipais em Maio de 2008 (com o PDGE a conseguir 99 dos 100 lugares do Parlamento), as presidenciais de Novembro de 2009, que Obiang venceu com 95,4% dos votos e um referendo constitucional que visava aumentar os poderes presidenciais, aprovado com 97,7% dos votos).

⁴²¹No entanto, este poder é apenas formal, visto a vida política do país ser dominada pelo Presidente.

⁴²²NF = Não Livre, de acordo com o inglês *Not Free*.

liberdades civis dos seus cidadãos. No relatório anual *Freedom of the World* da *Freedom House*, pode ler-se que a Guiné Equatorial é “one of the most repressive states in sub Saharan Africa” (Freedom House, 2012). O relatório fala, ainda, na subida recente do número de prisões arbitrárias feitas pelo regime. A falta de independência do sistema judicial, o controlo apertado às forças da oposição, a autorização da censura e os altos níveis de corrupção do país, cuja vida económica é dominada pela família do Presidente Obiang (o artigo cita os *rankings* da ONG *Transparency International* de 2011, que colocam a Guiné Equatorial na 172ª posição, num total de 183 países) são outras das críticas apontadas ao regime. Um outro ponto do relatório digno de nota é a proibição feita aos meios de comunicação social⁴²³, impedindo-os de transmitir notícias relacionadas com as revoltas nos países árabes. O único jornalista que mencionou a Líbia numa peça noticiosa foi suspenso e espancado pela segurança do Secretário de Estado da rádio e televisão do país. Para além destas acções repressoras, existem ainda outras, como as repetidas perseguições aos imigrantes.

A Guiné Equatorial é um dos países mencionados no relatório *Worst of the Worst* de 2011 (última edição) da *Freedom House*, que reúne os países e territórios que obtiveram uma média entre 6,5 e 7 nos *rankings* do *Freedom of the World*.

Economia

Segundo dados do *World Factbook* da CIA e do Departamento de Estado norte-americano, a Guiné Equatorial tem um PIB de 26,6 mil milhões de dólares e um PIB per capita de 19 mil e 300 dólares. A economia é altamente impulsionada pela produção e exportação de petróleo. O petróleo e produtos derivados foram responsáveis, em 2010, por 97% do total de exportações, o que explica que o crescimento económico flutue de acordo com os preços do crude no mercado mundial: esta é a razão pela qual, depois de 2009, quando o PIB cresceu 5,9%, houve uma retracção de -0,8% em 2010. O *World Factbook* estima um crescimento de 7,1% em 2011. Os EUA são o maior destinatário das exportações da Guiné Equatorial, que tem na China o principal mercado de importações. As principais importações da Guiné Equatorial prendem-se com equipamento para o sector petrolífero, materiais de construção e veículos.

Conclusão

Recapitulemos as conclusões dos estudos mencionados no início. De acordo com a tipologia de regimes apresentada por Bogaards (2009), a Guiné Equatorial é um regime autoritário fechado, visto corresponder ao domínio de um partido único sobre o aparelho estatal, bem como uma liderança personalista – no caso, do Coronel Obiang e da sua família, como a citação de Hyden (2006) no início deste ensaio assim atesta.

No seu estudo, Hadenius e Teorell (2006) apontavam um regime autoritário multipartidário como o que menos resistência oferece numa transição para a democracia. O facto da Guiné Equatorial não o ser, não permitindo o debate que esses regimes autoritários multipartidários têm forçosamente de aceitar não indicia que uma transição para a democracia esteja na calha para breve. As conclusões de Bratton e van der Walle (1997) – de que essa transição é facilitada quando existe um nível mínimo de competição – também não se verificam na Guiné Equatorial, nem dentro, nem fora do PDGE: o Coronel Obiang e o seu filho Theodoro dominam o partido, que por sua vez domina o aparelho de estado e o país.

Gandhi e Przeworski (2007) referem que se necessário os regimes autoritários, se necessário, recorrem a algum grau de abertura política na procura de uma base de apoio e dão como possibilidades os autocratas ao comando desses regimes permitirem membros da oposição no Parlamento. Estas conclusões parecem verificar-se na Guiné Equatorial. Depois de pressões

⁴²³Todos sob o monopólio do estado, à excepção da RTV-Avonga, uma companhia de rádio e televisão cujo proprietário é o filho do Presidente Obiang; o seu putativo sucessor.

internacionais em 1991, o coronel Obiang prometeu um regime multipartidário que, embora nunca tenha chegado a existir na prática e as eleições desde então tenham sido consideradas fraudulentas, existe um membro da oposição no Parlamento. Mais claro é outro exemplo, também referido anteriormente neste ensaio, que dá conta de Obiang ter feito uma coligação com 9 pequenos partidos políticos. No entanto, a oposição é atentamente viajada e controlada pelo regime logo não podemos tratar este assunto com a clareza necessária.

Quanto ao estudo de Harber (2002) em que é defendido que os regimes autoritários atrasam o crescimento económico, não podemos saber qual seria o nível de crescimento do PIB da Guiné Equatorial se esta fosse uma democracia⁴²⁴. Um aspecto do estudo parece-nos, no entanto, inevitável de concluir: dos seis malefícios que Harber defende que os autoritarismo trazem, pelo menos dois parecem ser verificáveis. Este são o florescimento da corrupção que os regimes autoritários provocam e o clima de intimidação e repressão contínuos que trazem consigo. Como já referido no ensaio, um relatório da *Transparency International* coloca a Guiné Equatorial em 172º lugar no ranking dos países mais corruptos (em ordem crescente), num total de 183. Quanto ao clima de repressão, os *rankings* da *Freedom House* falam por si.

Finalmente, analisemos os dois estudos de Smith (2004) e Jensen e Warchekon (2004), começando por este último. Os seus autores defendem que entre 1975 e 1990 os países ricos em recursos tenderam a ter mais regimes autoritários. Ora, a Guiné Equatorial só descobriu reservas petrolíferas em 1996 e portanto o estudo não se aplica. Já quanto às conclusões de Smith (2004), segundo o qual os regimes com petróleo verificam menos protestos e tendem a ter uma maior durabilidade, é difícil verificar a sua aplicabilidade à Guiné Equatorial visto o regime ter mantido um apertado controlo sobre os direitos políticos e liberdades civis praticamente desde a independência. Independentemente disso, e tendo em conta as conclusões dos outros estados e a nossa própria análise, o regime autoritário na Guiné Equatorial parece solidamente instalado e sem sinais de reforma num futuro próximo.

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METHODOLOGY OF UTILIZING THE TEACHING OF ISLAMIC LAW AND ITS PRINCIPLES IN ENHANCING MODERATION: "A CRITICAL STUDY FOR THE CONCEPT AND APPLICATIONS"¹

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Abstract:

It is an essential necessity in the contemporary world to enhance moderation and tolerance, as terrorism and mutual intolerance have become major problems that threaten the foundations of world peace. This situation has resulted in the emergence of a dramatic increase in research interest in various field of study to investigate the reasons behind this dangerous phenomenon, and to try to identify solutions to remedy the problem.

Although the response of Islamic researchers has been broad, the general tone seems defensive and apologetic, at times to the point of disregarding the practicalities of treating the problem.

In view of the facts outlined above, this project aims to shed light on methods of utilizing the teaching of Islamic Law and its Principles in a way that allows graduates to be more effective in disseminating the values of moderation and challenging intolerance and terrorism in our societies. Hence, the long-term goals of this project are to assist in spreading general awareness in this concern, and tolerant attitudes, as well as supporting the concept of coexistence and supporting human rights.

The specific objectives of this project are to establish a practical, comprehensive program to utilize the teaching of Islamic Law and its Principles in enhancing moderation and tolerance.

The outcome of this research is expected to influence a large number of Islamic studies graduates and youth in the Muslim world. Improving the performance of faculties of *Shari'ah*, Islamic Studies, is another important goal of this project.

Literature Review: reviewing the available literature of Islamic Studies in this respect, one can argue that it is difficult to find research that provides a clear method to enhance moderation and tolerance from the academic field targeted in this project. However, there are several published pieces of research which are related to the scope of this research in Islamic literature. For example, the papers presented at the Islamic conference of: "Moderation is a Way of Life ", which was held in Kuwait in 23/5/2005.

These research papers represent a positive contribution to the field by studying the concept of moderation and clarifying its application in Islamic sources, as well as in the different fields of Islamic Law. This is in addition to the relationship between moderation and civilization, and its role in media. Further, some of these efforts were devoted to shed light on intolerance in particular. They assess its causes and solutions. However, there is still a lack of research relating to the question: How can we utilise teaching Islamic Law and its Principles in enhancing moderation and tolerance?

Research Method: The researcher will undertake the following methods to achieve the objectives of this project. Firstly, the concept of moderation is assessed by consulting the sources of Islam to determine its relevance. Secondly, the means of enhancing moderation in thinking and practice are derived from the sources of Islamic Law and its Principles, by applying the derived elements of moderation. Thirdly, applicable conclusions and recommendations are determined as a conclusion, to outline the main features of the objective methodology.

Key Words: Islamic studies, methodology, principles

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Concept of Moderation and *al-I'tidal*, in Islamic literature and Related Aspects

There are many interpretations for Moderation and *al-I'tidal* in various Islamic resources. We also find a wide variety of concepts and their implementation derived from the sources of Islamic Law and its Principles, by applying the derived elements of moderation. Applicable conclusions and recommendations are finally determined which allow the portrayal of the main features of the Methodology to be adopted as a base for further study and problem solving.

Moderation in the Arabic Language

1. *Al-Wasatiyyah*: derived from, *Wasat*, meaning moderation in all things good or bad, it also takes the meaning of being just, and goodness⁽¹⁾.
2. *Al-I'tidal*: derived from just, meaning incorruptibility⁽²⁾.

Al-Wasatiyyah and *al-I'tidal* in the Arabic language give the same meaning, and they are the opposite of extremism, which is exceeding moderation, or lack of moderation⁽³⁾.

The researcher merges the interpretation of both meanings of the Arabic words into one word in English moderation: following the right path avoiding extremism or exorbitance to the betterment of justice and goodness.

The Holy Qur'an and its Exegesis

Moderation is mentioned in several places in the Qur'an, giving various meanings, one of which is widespread: *'Thus, have We made of you an Ummat justly balanced, that ye might be witnesses over the nations, and the Messenger a witness over yourselves; and We appointed the Qibla to which thou wast used, only to test those who followed the Messenger from those who would turn on their heels (From the Faith). Indeed it was (A change) momentous, except to those guided by Allah. And never would Allah Make your faith of no effect. For Allah is to all people Most surely full of kindness, Most Merciful.'* *Al-Baqarah 2:143*

Abu Ja'far al-Tabari explains: "I see that moderation in this verse, being the middle between two points, for example the middle of the house, it also means the best of people who are moderate in their actions and choices"⁽⁴⁾.

It is worth mentioning that the word *I'tidal* has not been mentioned in the Holy Qur'an, but it is understood and mentioned in other variations, Allah the Almighty says: *'Allah commands justice, the doing of good, and liberality to kith and kin, and He forbids all shameful deeds, and injustice and rebellion: He instructs you, that ye may receive admonition.'* *Al-Nahl 16:90*.

It has been explained in the *Tafsir* books that *al-Adl* means following the right path, avoiding extremism or exorbitance⁽⁵⁾.

Al-Razi considers both terms *Al-Wasat* and *Al-Adl*, and they take the meaning of avoiding extremism or exorbitance. It is the middle ground which believers seek to follow, and they ask Allah to guide them to that⁽⁶⁾.

Al-Jurjani differentiates between extremism and exorbitance, the first implies failing to reach the point of moderation, the latter implies exceeding the limit in order to achieve extreme perfection⁽⁷⁾.

The term *al-Mustaqim* which is stated in the verse: 'Show us the straight way'. *Al-Fatihah 1:6*; means the moderate path of Muslims that avoids extremism or exorbitance⁽⁸⁾. Thus, *al-Istiqamah* means to follow this straight path⁽⁹⁾.

However, *al-Qist* in the verse: *'Say: "My Lord hath commanded justice; and that ye set your whole selves (to Him) at every time and place of prayer, and call upon Him, making your devotion sincere as in His sight: such as He created you in the beginning, so shall ye return."* *Al-A'raaf 7:29*; is the just path, also known as moderation; avoiding all means of extremism or exorbitance⁽¹⁰⁾.

From the above we deduce that *al-Wasat*, *al-Adl*, *al-Qist*, *al-Istiqamah*, and *al-Sirat al-Mustaqim*, all take on the same meaning.

The Tradition of Prophet Muhammad

Al-Wasatiyyah and *Al-I'tidal* have been mentioned in many texts of the Prophet's Traditions, which add important specifications to the concept Moderation, aiding in defining the methodology of deciding its practical interpretations, in order of importance as follows:

- a. *Abu Hurayrah* narrated that the Prophet *Muhammad* -peace be upon him- said: "the best of things are in moderation"⁽¹¹⁾. This means that most choices are moderate between two undesired outcomes; it is the lesser of two evils. For example generosity is moderation

between stinginess and overspending; Honesty is moderation between lying and being rude⁽¹²⁾.

b. *Abu Hurayrah* narrated that the Prophet Muhammad -peace be upon him- said: The deeds of anyone of you will not save you (from the (Hell) Fire)." They said, "Even you (will not be saved by your deeds), O Allah's Messenger (ﷺ)?" He said, "No, even I (will not be saved) unless and until Allah bestows His Mercy on me. Therefore, do good deeds properly, sincerely and moderately, and worship Allah in the forenoon and in the afternoon and during a part of the night, and always adopt a middle, moderate, regular course whereby you will reach your target (Paradise)⁽¹³⁾.

Al-Nawawi explains the clause: "*Saddidu wa Qaribu*"; ask guidance of Allah in what you do, if you can not achieve that, be as close as possible to what pleases Him, *al-Saddad*: righteousness, in moderation between excessiveness and don not over-indulge, or fall short⁽¹⁴⁾.

b. *Abu Hurayrah* narrated that the Prophet Muhammad -peace be upon him- said: 'Religion is very easy and whoever overburdens himself in his religion will not be able to continue in that way. So you should not be extremists, but try to be near to perfection and receive the good tidings that you will be rewarded; and gain strength by worshipping in the mornings, the nights.'¹⁵ This is considered one of the most important Hadiths for moderation; because it reiterates that avoiding extremism and encouraging moderation in all aspects is mainstream in religion. This point is also mentioned in the Holy Qur'an: '*Allah intends every facility for you; He does not want to put to difficulties.*' *Al-Baqarah 2:185*. This means choosing the easiest option within the parameters of Islam. Al-Sakhawi says: '*Saddidu wa Qaribu*' means: "Aim to choose the closest to the correct path, Do not over-exert yourselves in worship, lest you get bored, then you would err on the side of negligence"⁽¹⁶⁾.

Schools of Islamic Law

Both concepts of *al-Wasatiyyah* and *al-I'tidal* have the same interpretation in references of the four schools of Islamic law that previous resources follow, in the Arabic Language, The Holy Qur'an, and Hadith⁽¹⁷⁾.

The terms are also used to refer to something in the middle of two objects¹⁸.

Scholars have also applied them to indicate that moderation in an adjective¹⁹.

Jurists use the term to instigate the middle ground between over spending and not spending at all *-al-Ifrat* and *al-Tafrit*⁽²⁰⁾.

Al-I'tidal has also been in terms of the right way, Al-Bahuti says: "*Al-Qasd* and *al-I'tidal* as Allah mentioned in the Qur'an "*And pursue the right course in thy going about*". *Luqman 31:19*⁽²¹⁾.

As noted the terms are used by jurisprudence scholars in the same manner as previous recourses. This is as close as possible to the concept in the interpretation of Qur'an and the Arabic Language.

Islamic Ethical Perspective

Scholars of Ethics have considered both Moderation and *I'tidal* to be one and the same in terms of concept; they have all interpreted good manners as being the middle choice between two extreme actions, or the middle ground between two ends of spectrum⁽²²⁾⁽²³⁾.

Moreover, Scholars of Ethics have added the concept of Justice and *I'tidal* declaring that it pertains to three main morals, which encompass all others, Wisdom (*Al-Hikmah*), Bravery (*Al-Shajaa*), and Abstinence (*Al-Iffah*).

Some scholars of Islamic Legislation have also agreed to this⁽²⁴⁾.

According to this concept, *al-Wasatyeh* and *al-I'tidal* as concepts regarded as inherent in every characteristic that has all three ethics of wisdom, bravery and abstinence. Any characteristics that do not encompass those three primary ethics are considered void of the concept of moderation⁽²⁵⁾. This is explained in the following:

1. *Al-Hikmah*: Choosing middle ground between obsessive evil thinking on one hand, and idiocy and ignorance on the other. The capacity to maintain *Al-Hikmah* is considered to be an advanced capability of the human brain.

2. *Al-Shaja'ah*: Choosing the middle ground between aggressive confrontation and cowardice is considered to be a result of reigning-in and controlling the force of anger in oneself.
3. *Al-'Iffah*: Choosing the middle ground between pursuing desires, and not having any at all, is attained when a person controls their inclinations.

Contemporary Islamic School of Thought

Modern researchers have addressed the previous concepts in their studies as well, through their publications and participation in related conferences. They have agreed to adopt the concept of Moderation, and used it as a baseline for their research in this field. The most fundamental addition to the concept of *al-Wasatiyyah* and *al-'I'tidal* in modern research is reprobate extremism and terrorism, which are the complete opposite of Moderation. They have also consolidated the concept of tolerance as an important practical application of moderation, along with facilitating the concept of ease and alleviating hardship. These concepts have become the focus of consideration in these times due to current events and developments. In our small village of The World, we have become inseparable from one another, which has given rise to security concerns resulting from extremism and terrorism. Some of these acts have been wrongfully associated with Islam; in essence Islam is a moderate and just religion. For that reason, scholars have recently given special attention to the subject matter, though it has been discussed previously under the concept of moderation⁽²⁶⁾.

This has been highly stressed in "The Amman Message"; a Royal Jordanian message to the world adopting a reformist Islamic vision extracted from moderation and *al-'I'tidal*, built on authentic Islamic resources. It is a call for a moderate point of view and respect for others, and denouncing all forms of extremism⁽²⁷⁾.

The Chosen Interpretation of *Al-Wasatiyyah* and *Al-'I'tidal*, and their Components

Through extensive reading of Islamic resources in this matter, the researcher defines moderation as: "Following the just path by avoiding *al-Ifrat* and *al-Tafrit* religiously and sensitively."

Al-Wasatiyyah; moderation between *Ifrat* and *Tafrit*, *Al-'I'tidal*; the just which leads to following the right path and adhering to righteousness. The main resource is Islamic legislation, in accordance with the edicts of the Council of Wise Men, the indication is to conform to the three basic ethics i.e. wisdom, bravery, and abstinence.

One of the recommendations of the moderation is a way of life conference: "General features of moderation are embodied in righteousness, following the straight path, seeking ease and avoiding hardship, choosing the middle ground, being just, being aware of current issues and concerns, those concepts won't be realized until recognizing and completely understanding the limits of *al-Ifrat* and *al-Tafrit*"⁽²⁸⁾.

We conclude that the crucial elements to complete the concept of *al-Wasatiyyah* and *al-'I'tidal* are:

1. Following the right path and righteousness.
2. Seeking ease and avoiding hardship.
3. Being just and following the middle ground between *al-Ifraat* and *al-Tafrit*.
4. Abiding by three major virtues: Wisdom, courage, and abstinence.

The most important elements in adopting the concept in modern times are:

- a. Avoiding violence, and extremism.
- b. Maintaining tolerance and respect for others and their rights.

Applying the Elements of Moderation in Teaching Islamic Law and its Principles

The discussion in the previous section leads the researcher to adopt specific elements in the process intended to apply moderation through the teaching of Islamic Law and its Principles.

Determining the Limits of Excessiveness, *al-Ifrat*, and Negligence, *al-Tafrit*, as a Major Reference for Teaching Islamic Law and its Principles

Moderation is one of the most important characteristic of Islamic Law, as its concept is found in the middle between two undesirable traits: those of excessiveness and negligence. It is important to apply limits to these two concepts in the teaching process in this field. The following are major references that are used to specify the limits.

Activating Stable and Consistent Rulings of Islamic Law

Stability is one of the main characteristics of Islamic Law⁽²⁹⁾, when applied giving it its independent nature. It also outlines the most important limits for its concepts and rulings. Further, it determines the bulk of limits of extremism and negligence.

Teaching consensus, *al-Ijma'*, and emphasizing the importance of respecting it is a vital way for determining these limits, and ensuring their stability. For this reason some scholars of *Usul al-Fiqh* discussed the concept of moderation through their assessment of the consensus as a main source of Islamic Law⁽³⁰⁾. However, it seems that the consensuses that exist in all subjects of this field of study are taught without sufficient analysis to illustrate their wisdom and impact on moderation. Hence, it is essential to revise its role in all aspects of the field.

Understanding the Objectives of Islamic Legislation, *Maqasid al-Tashri'*, the Stable Rulings of Islamic Law

The induction of the rulings of Islamic Law leads the scholars of *Usul al-Fiqh* to arrive at specific objectives according to major criteria which can be utilized in assessing the different issues of life. The protection of the 'five essentials' is considered an objective for Islamic legislation on the one hand, and a stable standard for judging and reasoning on the other⁽³¹⁾. Therefore, anything which runs counter to the protection of man's religion, soul, mind, progeny and honour, or property is forbidden. This is due to the fact that such rulings would expand the acceptable limits of moderation and may proceed through the limits of either extreme or negligence.

Implementing Cultural Traditions and the Opinion of the Majority of Wise People

There are many cases where revelation is silent about the ruling of a certain topic. There is a need to strike a moderate stance between the limits of extremism and negligence. The common sense of the ordinary man or the deliberation of the wise is a reference in this case⁽³²⁾.

Teaching custom, *al-'Urf*, which is a source of Islamic Law, is a practical way to enable students to implement this reference in their judgments to the related cases. This is so, as it stands practically for a ruling that comes from the public interaction, without an intended organisation⁽³³⁾.

Further, teaching judicial conditions stipulated for judges in Islamic Law is also effective, as the judge should be clever, wise and pious in a way that he is considered as a reference in evaluating the different legislation, including the estimable things⁽³⁴⁾. Moreover, teaching the process of arbitration also should enable students to achieve the same conclusion. These studies focus on practical application to arrive at a moderate outcome in this concern.

Consulting the Three Major Ethical Values of Wisdom Abstinence and Courage as Standards for Moderation

These three values are implemented widely in Islamic Law.

Students should be trained to adopt wisdom as a basic element and reference of moderation, and apply it in their behaviour and intellectual interaction. This could be achieved through teaching them through examples of the application of the Islamic judicial system, political system, and methods of research in Islamic Law. Wisdom means to place everything in its rightful situation or order⁽³⁵⁾.

The method used in teaching Islamic Law, which is based on justification and clarification of the wisdom behind the legislation of each ruling in this Law, is also quite effective when teaching the student to adopt the concept of wisdom as a major standard of thinking and reasoning. The same argument is valid when teaching the objectives of Islamic legislation, *Maqasid al-Tashri'*, as they assess the wisdom behind the entire Islamic legal system, the essence of which is guidance and moderation⁽³⁶⁾.

Further, it should be noticed that the condition of *al-Munasabah*, i.e. eligibility for deducing cause of the ruling, which is stipulated for the validity of the analogy process, is a worthy subject of study for its emphasis on wisdom because it makes wisdom a reference for the acceptable cause of the ruling. Therefore, any cause which does not achieve a sensible outcome by the application of the ruling in real life situations is not considered valid⁽³⁷⁾.

Moreover, the rules and ethics of Islamic Legal disagreement embody many standards and rules of etiquette that are examples of the concept of wisdom. Hence, teaching them in a critical applied way will very likely result in students attaining the required level of wisdom.

Adopting Righteousness, *al-Khayriyyah*, as a Foundation for Teaching Islamic Law and its Principles

Righteousness is a major element of moderation and one of the most important results arising from its application. However, it requires reaching the best conclusion possible. This could be attained by applying the previously mentioned *Hadith*, tradition of the Prophet Muhammad, peace be upon Him: "*Saddidu wa Qaribu*" i.e. " ... Do good deeds properly, sincerely and moderately, and always adopt a middle, moderate, regular course whereby you will reach your target"⁽³⁸⁾. Accordingly, following the righteous way, which is based on moderation, is the authentic Islamic way that should be applied in thought, research, and behaviour. One can argue that there are two methods for attaining righteousness and moderation. The first is trying to attain the best and perfect level in everything, if it is possible. The second is to be as close to the best as possible, in case perfection is not accessible. This could happen for many reasons such as contradiction of texts⁽³⁹⁾, conflict of individual and public interests, or two types of harmful options. However, contradiction is treated in Islamic law and its Principles in a significant way, which could also be applied to enhance moderation. The following are examples of that.

The roles of Preference, *al-Tarjih*, is assessed in depth in *Usul a-Fiqh*, in a manner that illustrates the means of tackling a contradiction in the interpretation of texts or reasoning⁽⁴⁰⁾. Further, the legal maxims of harm elimination are based on the preference of the less harmful, or the most beneficial of the contradicting harms or benefits⁽⁴¹⁾. Consequently, teaching these maxims and their applications and examples in an analytical way enriches the students noticeably in achieving the goal mentioned.

Easing and Facilitating Hardships as a Foundation for Teaching Islamic Law and its Principles

Islamic Law is the spiritual and practical reference for the Islamic Nation. It governs all aspects of life for Muslims. Therefore, as a body of Sacred Law which adopts moderation as a mainstream concept, it should facilitate ease for the people and alleviate hardships for them⁽⁴²⁾. Allah the Almighty says in the Holy Qur'an: '*Allah intends every facility for you; He does not want to put to difficulties.*' *Al-Baqarah 2:185*.

The concept of moderation is applied in different ways in teaching Islamic Law and its Principles through several courses. In *Usul al-Fiqh*; there is in-depth study of the conditions pertaining to the object of a legislated ruling, *al-Mahkum Fih*, in a special course of religious ruling. All types of hardship and the Islamic means of avoiding them are assessed. Further, this concept is highlighted in the study of the main objectives of Islamic legislation; under the subject of the Islamic protection of the interests of man.

The courses on worship and rituals give a significant reference to the concept of moderation as a major principle in governing them.

The module of Legal Maxims particularly emphasizes moderation and its concept, specifications, conditions, and applications. This is in view of the fact that, one of the five major maxims that govern the entire body of Islamic Law is 'Hardship leads to facilitation'⁽⁴³⁾.

Teaching Respect for Differences of Opinion and the Rights of Others and their Impact on Moderation and Tolerance

Mutual respect for differences of opinion should constitute a major element of moderation in debate. Modern life can be characterized as having a far greater level of interaction between divergent societies than was common in the past, and what is referred to as terrorism has increased noticeably in recent decades, constituting a serious threat to world security and social stability. Consequently, subjects relating to tolerance must be given special care and in-depth assessment through the teaching of Islamic Law and its principles. Tolerance should be promoted through study, and misconceptions should be refuted in order to achieve better outcomes in the teaching of moderation. Accordingly, legal disagreement, ethics, rights of minorities, human rights in general, terrorism and the concept of *Jihad* and its rulings, and the main rules concerning respect in international relationships must be studied carefully⁽⁴⁴⁾.

The facilitation of disagreement in jurisprudence, mainly between the Islamic schools of Law is taught in the course of Comparative Jurisprudence, *Fiqh*. This module concentrates on illustrating the reasons and philosophy of disagreement in Islamic Law, its main schools, and the method of comparing between them on controversial issues. However, there seems to be a need to adjust the material used in such a manner that they focus more on the ethics of dealing with differing opinions

and trends. The vast body of Islamic heritage in the books of what is referred to as the Ethics of Knowledge, *Adab al-^cIlm*, and the ethics of reasoning, *Adab al-Mufti wa al-Mustafti*, have a comprehensive approach, which is more than sufficient to achieve the required tolerance and balance between the different Islamic sects⁽⁴⁵⁾. Hence, more emphasis should be placed on highlighting these ethics in this course. Emphasis should not be placed on the study of methods and rulings at the expense of assuring ethics and tolerance.

The course on Islamic political systems offers an opportunity to assess the level of tolerance within the Islamic legislature concerning the rights of minorities within Islamic society, along with questions of human rights. Promoting moderation in this respect definitely makes sense⁽⁴⁶⁾.

The module of International Relations in Islam allows for comparative analysis pertaining to the subjects of causes of differences of opinion within the legislature, its conditions, terrorism, rights of civilians, the concept of *Jihad* and related misconceptions, international treaties, and interaction⁽⁴⁷⁾.

Supportive Elements for Utilizing the Teaching of Islamic Law and its Principles in enhancing Moderation and Tolerance

The following are further issues that arise from the teaching of this major supporting the academic outcome related to moderation in thinking and practice.

The Correct Understanding of Islamic Texts and its role in achieving Moderate Outcomes

All Muslims refer to the texts of the Holy Qur'an and the Sunnah of Prophet Muhammad to derive guidance for their way of life, particularly the legal texts which relate to interactions, rights, and practices. Hence, moderation can only be achieved by following a fair and just way of interpretation. Lack of understanding, or misguided interpretation leads to either; excessively liberal, or intolerant practices. This negatively impacts both the individual and society. Consequently, it is important to emphasise the means and reasoning behind authentic understanding of the holy texts.

Teaching Islamic law in a comparative way between the different schools of Islamic Law is one way of enabling students to achieve that. This is so because the process of comparison supports divergent points of view and reasoning on a given issue. This trains students to apply the theoretical rules of interpretation in separate themes of law relating to the various aspects of life.

Further, special emphasis must be accorded to the courses of *Usul al-Fiqh* for teaching the subject of textual indications, *al-Dilalat*, as they instruct on the basic elements of the rules of interpretation. It seems that there is more concentration on verifying the rules and concepts rather than practicing interpretation⁽⁴⁸⁾. This can be seen through the books taught in this field. Serious effort must be made to change the focus to investment in the comprehensive rules identifiable within the texts. This would be more effective for students in terms of comprehension and relevant application.

Moreover, the course which is devoted to teaching the subject of reasoning and imitation, *al-Ijtihad wa al-Taqlid*, is quite crucial in allowing students to reach the level required for proficient understanding of the texts. This course illustrates the conditions stipulated for reasoning which aim to limit the authority of interpretation of the sacred texts to the jurists and real scholars, who are qualified to reason religiously, in terms of language, knowledge of Qur'an and the *Sunnah*, methods of derivation, and moral behaviour. Rules of imitation and following scholars and their reasoning opinions are also examined⁽⁴⁹⁾. Learning these methods and rules enables students to determine how to research and analyse texts correctly in order to correctly derive Islamic legal rulings, and how to imitate existing righteous reasoning of scholars and qualified researchers.

Emphasising Awareness of the Context of Time as a Means to Emphasise Moderation

The time context is as important as the textual context in taking decisions and deriving an appropriate ruling in a given case or issue. To ignore the context of time is to cause inflexibility and hardship in the application of Law. Therefore, students should be taught the various subjects of Islamic Law in view of the reality of the conditions available and the actual circumstances, within the context of time and place. It is worth noting that there are several impractical attitudes prevailing in the discipline of contemporary reasoning which could be described as inaccurate. The reason behind this trend indicates lack of awareness of contemporary conditions. Consequently, all courses of Islamic Law should be taught according to this main principle to emphasise moderation and tolerance in teaching outcomes.

Further, it seems that there is lack of teaching for this major principle in the courses of *Usul al-Fiqh*, especially the course of reasoning and imitation, where there should be sufficient clarification of the conditions and rules to determine whether or not the contemporary context exists. Further, the

subject matter of *Tahqiq al-Manat* which stands for 'Ascertaining the Effective Cause' is a very effective method for enabling students to apply the rules in actual cases⁽⁵⁰⁾. This type of reasoning is referred to as analogy mainly, but actually it is related to the reasoning of implementation. This practical and effective method is taught briefly and superficially by assessing its concept and presenting a few examples. It requires serious revision for clarification and to enable its correct application.

One can argue that the largest two sources of Islamic Law in terms of flexibility are Public Interest, *al-Maslahah al-Mursalah*⁽⁵¹⁾ and Custom, *al-'Urf*⁽⁵²⁾ due to the fact that they are changeable according to the variations of place and time. Assessing the teaching materials, it seems here also that there is lack of practical training for students concerning the application of the rules and methods related to these sources in reasoning for contemporary life situations.

To promote the courses mentioned above and to reach a better awareness of contemporary circumstances, which is a step towards emphasizing moderation, the researcher suggests the following.

a. Teach students the difference between stable rulings in Islamic Law and flexible rulings. The first category refers to those rulings that are derived from definite texts, in terms of indication and authentication. The other category relates to the majority of rulings in Islamic Law which are related to either indefinite texts, regarding indication, or authentication⁽⁵³⁾. However, the second category of rulings is very likely affected by the actual circumstances, which is the opposite of the case with the first one.

b. Directing students to study the subjects assessed as they exist in real life. They should consult other fields of study in order to specify the actual situation of the issue and its application.

c. Assessing the different possibilities, cases and types is important. This includes taking into account the expected consequences of a ruling⁽⁵⁴⁾.

Recommendations

1. Faculties should focus research on crystallizing the concept of Moderation and *al-I'tidal* by fine tuning presentation and seeking means of enhancing its virtues in students, and by framing the message and educational output within all subjects of Islamic Law and its Principles.
2. Instilling the principles of Moderation and its rulings by applying its components through any means applicable, such as visual aids, and breaking up the concept into smaller segments to accommodate different types of perception and understanding. This will lead to a more comprehensive understanding of moderation in the context of Islamic Law and its principles. Consequently, we will create a body of students able to embrace it and be the personal and academic embodiment of moderation, applying it in all aspects of life, which in turn will produce a highly desirable ripple effect of moderation in society.
3. Designing a new subject in Islamic Law of Moderation and applying it to all colleges, including Islamic Law and Its Principles. There is an urgent need to study this subject within the context of contemporary circumstances due to its varied nature and the effect it will have on other subjects.
4. Enhancing applicable resources of Islamic law and its principles by reciting relevant historic events, studying the life of Prophet Mohammad--peace be upon him--and the history of Islamic jurisprudence and its scholars.
5. Enhancing the relevance of jurisprudence to contemporary times by introducing the requirements of temporal and spatial context for the application of Islamic Jurisprudence that does not contradict or deviate from basic known constants.
6. Including the latest research citing the most important manifestations of extremism in subject matter, and refuting the allegations of those who adopt it, by providing evidence from textual revelation, and rational substantiation. Eradicating all that contradicts with Moderation will correct the wrongful beliefs adopted by some students, enabling them to replace their erroneous perceptions with a wider perspective and more tolerant behaviour.
7. Utilizing concepts of comparative study in all subjects, to apply it in understanding the concept of the greater risk and lesser of two evils, achieving balance between public and private interests, understanding current events within the context of protecting the future, and balancing between living this life and the hereafter. All of the above have a great impact on realizing moderation in tangible concepts.

8. Enhancing the study of comparative Islamic Law in different courses to teach disagreement etiquette, accepting of the other, respecting different viewpoints, always relying on solid selective evidence, and not following one's own desires or other opinions blindly. Comparative study suppresses the tendency to a unilateral point of view and broadens students' horizons, exposing them to multiple points of view relating to Islamic issues, and teaching them not to confine themselves to one ruling, because the truth has many faces.
9. Teaching the Philosophy of Islamic law and its principles, to transform the students literal understanding of the rulings to a deeper and more comprehensive understanding of critical dimensions of the rulings of Islamic Legislation. Enhancing students' innate ability to systematically create links between different subjects, and create a cohesive system with general characteristics and objectives. The most important methods of enhancing intellectual depth are:
 - a. Study of the Rationale of Islamic Jurisprudence and Reasons of Rulings.
 - b. Analysing the methods of jurists in Reasoning and Preference.
 - c. Study of Objectives of Islamic Legislation and its Applications.
 - d. Analysing Islamic legal systems, and realizing the need to understand their dimensions and characteristics as well as the importance of their application.
 - e. Encouraging applied studies with a futuristic outlook and understanding of the consequences of the current rulings and how they can be applied to contemporary issues.

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THE VALUE OF NATIONAL PLURALITY IN THE DESIGN OF THE CONSTITUTIONAL STATE

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Abstract:

The constitutional changes that are taking place in Latin America have meant, for many of these countries, a profound *reform* (or, sometimes, *rupture*) in the "Model of Constitutional State" that sustains their democratic systems. 19th century Legislative State (*legalism* as a legal theory), whose applicability practically extended to the 20th century and beyond, is being substituted on the whole by a Constitutional State configured in the paradigm of *neo-constitutionalism*, a prototype that we modern democracies are currently operating within. This is the case for Bolivia, wherein the 2009 Constitution established a "Plurinational Constitutional State", with all of the implications that this has meant for the design of the institutional aspect of the country.

Key Words: National Plurality, Constitutional Values, Constitutional State

Introduction: Decentralization and National Plurality of the Constitutional State

One new aspect of Bolivia's Constitution of 2009 is the inclusion of national plurality as one of the most important and transcendent moral, political and legal values of the Fundamental Law (Zagrebelsky, 2003, p. 150). The constitutional relevance of national plurality is so great that we could draw the conclusion that it is included in the Constitution as the "basic founding fact" of the (new model for the) Constitutional State and even the Constitution. National plurality pervades the State's institutional design at every level of authority. To a large extent, *control over the constitutionality* of this new model for the Constitutional State must be achieved by reference to a "sheaf of fundamental rights" whose background is expressly one of national plurality. Let us examine what this means in the Political Constitution of the Plurinational State of Bolivia 2009 (hereinafter referred to as the PCS).

Firstly, it can be inferred from a perusal of the 2009 PCS that national plurality is the "core connection" between the foundation of Bolivia's Constitution and the model of State it establishes. The collective statement in the Preamble to the Constitution gives an early indication of the "core" nature of national plurality: "The Bolivian people, of plural composition since the beginning of time"; "We populated this sacred Mother Earth with different faces, and since then we have understood the current plurality of all things and our diversity as beings and cultures. That is how we defined our people, and we never understood racism until we experienced it in the terrible days of colonisation". The Bolivian people, [...] built a new State ...with respect to the economic, social, legal, political and cultural plurality of the habitants of this land." Moreover, developing the constitutional statement along the same lines, the *core transcendence* of national plurality is evident in the fact that it is placed in Part One of the PCS on the *Fundamental Bases of the State. Rights, Duties and Guarantees*; Title I (*Fundamental Bases of the State*), Section II (*Principles, Aims and Values of the State*).

Secondly, in coherence with the above, national plurality runs through the entire PCS, evidencing a "mainstreaming" that has an *impact* on every norm in Bolivia's legal system, the entire political and institutional design, and even the fundamental rights. This means that national plurality *informs* constitutional law in its entirety, *with no exception*. The Constitution is *bound* by national plurality in its "moral" base, "spirit" and "objectives"; its "institutional" and "political" base; the

"system of rights"; the "duties" and "actions" of government authorities, and relationships between individuals; and, of course, "the constitutional justice system". The expressions of national plurality in the Constitution are made extensive to all the most important institutions of the reshaped State. In fact, many Bolivian institutions added "plurinational" to their names. Such is the case of the official name of the State, the Legislative Assembly, the Constitutional Court (the Plurinational Constitutional Court, hereinafter referred to as the PCC), and so on.

The Preamble is not the only indication of the mainstreaming nature of the moral, political, legal and constitutional value of national plurality in the Constitution, however. Article 1 PCS defines national plurality as a decisive element of the model of State established by the new Fundamental Law: "Bolivia is constituted in a Social Unitary State of Plurinational Communitarian Law, [...] intercultural, decentralised and with autonomies. Bolivia is founded on plurality and on [...] legal, cultural and linguistic pluralism [among others], within the country's process of integration." Moreover, Article 98.I PCS explicitly stipulates that "Cultural diversity forms part of the essential foundation of the Plurinational Communitarian State". It also states that "Interculturality (which will respect differences and under equal conditions) is the instrument of cohesion, and harmonious and balanced coexistence among all the peoples and nations that make up Bolivia." In this sense, national plurality, as an expression of cultural diversity in Bolivia, is deemed by the Constitution as a "strength" to be made visible and not a weakness to be hidden (Article 98.II PCS), despite the problems that heterogeneity implies (Del Real Alcalá, 2005, pp. 177-195). In any case, heterogeneity causes infinitely fewer problems than the *failure to recognise* civilian society as a whole owing to marginalisation of a sector thereof.

Thirdly, the core connection of national plurality with the Constitution's foundations and the way it is mainstreamed into every political, legal, social and economic sphere at all levels of the State is no trivial matter. In fact, it means that national plurality actually "pre-dates" the State of Bolivia and the Constitution.

This pre-existence is manifested in two main ways: one, in the "empirical root" of national plurality; and two, in its "moral root". The "empirical root" of national plurality can be found in Bolivian civilian society, in the Bolivian people as a whole, and more specifically in the *constitutive* ethnic and cultural diversity that set it apart. In fact, Bolivia's heterogeneity became *national plurality* when it acquired *political* and *institutional* substance under the new Constitution.

If the empirical root of national plurality is the ethnic and cultural heterogeneity of Bolivia's civilian society, its "moral root" lies in the overarching value of the "human dignity" of individuals (*personal dignity*) and groups (*collective dignity*) (Asís Roig, 2002, pp. 153-176). This fact is highly relevant, because it helps to distinguish *prima facie* who the "holders" are of fundamental rights that are clearly rooted in national plurality, within the catalogue of rights recognised in the PCS. Outlining who are the holders of national plurality rights is not easy, however, especially with regards to collective groups.

The Constitution does not provide a clear answer to the issue of "which groups come under the PCS", for it states rather *vaguely* that they are the indigenous farmer nations and people, and the intercultural and Afro-Bolivian communities. Thus, strictly speaking, the PCS does not state clearly which are which. In the event of controversy and if there is no specific law that identifies them specifically, the vague wording would have to be decided by the Constitutional Court (Endicott, 2003, p. 179).

Fourth, if national plurality has a *core connection* to the foundations of Bolivia's Constitution and the model of State it establishes; is *mainstreamed* to every institution in the country at every level; and pre-dates the State and the Constitution owing to its *empirical root* (in the constitutive ethnic and cultural diversity of Bolivian civilian society) and *moral root* (in the overarching value of human dignity), we can only infer and conclude that national plurality is the "basic founding fact" of the Bolivian State and Constitution, given the way it is set out in the PCS of 2009.

Needless to say, national plurality, the crown jewel of Bolivia's Constitution, is the opposite value of the foundation of the preceding republican State (Quiroga, 2010, pp. 273-282). The latter, as a *one-nation State*, was born as a universal liberal State underpinned by the "*Staatsnation doctrine*" (Del Real Alcalá, 2007a, pp. 401-418) or the liberal process of nation-building. However, it soon shifted to a "*Kulturnation doctrine*" (Del Real Alcalá, 2007a, pp. 373ff.) of exclusion based on one culture and the marginalisation of diversity, although cloaked in abstract-formal guise.

Fifth, the “material content” of national plurality as the basic founding fact of the Bolivian State and Constitution is explicitly stated in the constitutional text. With regards to its moral dimension, for instance, it includes the “ethical and moral principles of plural society” recognised in the Founding Law, which the State “assumes” as its own and undertakes to “promote” (Article 8.I PCS: “ama qhilla, ama llulla, ama suwa (don't be lazy, don't be a liar, don't be a thief), suma qamaña (to live well), ñandereko (harmonious life), teko kavi (good life), ivi maraei (land without evil) and qhapaj ñan (noble life or path).” Other political principles that underpin the State and are related to the value of national plurality and its moral dimension are (Article 8.II PCS): “unity”, “inclusion”, “dignity”, “harmony”, “social equality”, “common well-being” and “social justice”. In any case, the constitutional notion of the common “good life” stands out in the moral content of national plurality as the key concept around which the Bolivian model of the social State is built, as set out in the PCS. Hence the close “structural connection” between the Plurinational State and the social State established by Bolivia's Constitution.

Naturally, the *ethical and moral* content of national plurality shows that, as a constitutional value, it is also a “driving force for equality” in Bolivia. As such, it is one of the salient *pillars* of the new “justice system” (*plurinational and intercultural*) that the PCS seeks to establish. In turn, the justice system is the main source of legitimacy of the Plurinational State that is set out in the constitutional text. This fact provides further evidence that the conceptual, institutional and constitutional design of the *plurinational* model of State erected in Bolivia can only be carried out via a *social State*.

In sixth place, lastly, national plurality is *specially protected* by the PCS as the basic founding fact that underpins the country's renewal. There are two types of protection. One is a “blanket protection” insofar as national plurality benefits from the protection of human dignity provided by the Constitution, due to its material connection to the overarching value of human dignity (Article 22 PCS: “The dignity and freedom of the person are inviolable. Respecting and protecting them is the fundamental duty of the State.”). However, it is also a “specific protection”, unique to national plurality as an essential constitutional value, according to Articles 98.III, 99.I and 100.I of the PCS.

The Value Of National Plurality And The Decentralization Of The Constitutional State

In view of the characteristics examined above, the *far-reaching* nature of national plurality in Bolivia's Constitution of 2009 is deployed throughout the entire constitutional text in the following “categories”, as:

- a “basic founding fact” of the (new model of) State and the Constitution, as we have seen in the preceding section.
- a “moral value” that *motivated* the constituent authority to draft a new Constitution.
- a “political value” assumed by the constituent (political) authority, and which the latter used to design the State institutions in the current Constitution. National plurality configures and *conditions* the manner in which the State has been organised at each of the institutional levels envisaged.
- a “higher legal value” that *pervades* the heterogeneous configuration of Bolivia's entire legal system and also the constitutional justice system set out in the Constitution (Peces-Barba, 1987a). The fact that national plurality is a *higher legal value* in Bolivia's legal system allows it to generate a *sheaf* of fundamental rights that are integrated by the Fundamental Law (Rojas Tudela, 2010, pp. 284-291; Ansuátegui, 2005). The main feature of the fundamental rights is that they share a common background of national plurality.
- a “constitutional principle” that will govern the actions of Bolivia's government authorities (Prieto Sanchís, 1998).
- the citizenship's “subjective rights” (fundamental constitutional rights), implemented as individual and collective *fundamental rights* based on the higher moral and legal value of national plurality (López García and Del Real Alcalá, 2000). Special mention should be made here of the rights of vulnerable groups such as the indigenous farmer nations and people, which are specifically recognised.
- a “legal duty” imposed on *government authorities* and the relations between *individuals* by the Constitution (Peces-Barba, 1987b, pp. 329-341), in favour of the citizens who *benefit* from the plurinational fundamental rights that are protected in the new Fundamental Law (Asís Roig, 1991).

The above examples are an indication of the way the constitutional value of national plurality is mainstreamed throughout Bolivia's Constitution. It has an *impact* on State bodies and every

political, legal, social and economic institution in the country, regardless of their size and at all levels. As I mentioned in the beginning of this paper, I have described these *organic* and *institutional expressions* of national plurality as "organic and institutional national pluralism".

They are what make the model of Plurinational State that has operated in Bolivia since the adoption of the PCS of 2009 so unique. To distinguish and clarify them will be decisive in the identification of the elements that are intrinsic to that model. I make a very brief analysis of this below, given the spatial limitations of this paper.

A) *Plurinational Democracy (Representative, Communitarian and Intercultural)*.

The expression of national plurality in the participation and composition of State Bodies and in political representation is related to the constitutional laws that make the composition of said (legislative, executive, legal and electoral) Bodies *plurinational* or the political representation of the citizenship that makes up said Bodies, respectively.

The institutionalisation of national plurality in Bolivia has an impact on the "Government System" (Chapter III, Title I, Part One), which stipulates in Article 11.I PCS that "The Republic of Bolivia adopts a democratic, participative, representative and communitarian form of government, with equal conditions for men and women". Here, the Plurinational State includes two methods of democratic representation. On the one hand, a *representative method based on universal, direct and secret suffrage*, as stipulated in Article 11.II.2 PCS (*Democratic representation*). On the other, the *method of communitarian representation*, in the spheres that envisage specific representation for the indigenous farmer nations and people – and similar communities – via the "election, appointment or nomination of authorities and representatives according to the norms and procedures of the indigenous farmer nations and people, according to law", as stipulated in Article 11.II.3 PCS (*Communitarian democracy*).

This gives rise to *intercultural* political representation, which includes the procedures of universal suffrage and communitarian representation, depending on the distribution of spheres in the PCS. Needless to say, the democratic methods set out in the PCS are a key element of *national plurality* in the State of Bolivia.

B) *National Plurality in the Territorial Model*.

This expression of national plurality is related to the constitutional laws that institutionalise national plurality in the territorial framework of the State by decentralising political authority. It is the result of the State of Autonomies model adopted by Bolivia, which leads to government at multiple levels.

The institutionalisation of national plurality *inspired* and *generated* the "territorial framework" adopted by Bolivia in the Constitution of 2009. The Constitution gives the central authority the mandate to institutionalise national plurality at territorial level via the decentralised distribution of political power at various levels according to the "list of competences" set out in the Constitution (Clavero, 2009, pp. 187-199). Thus, Article 1 PCS stipulates that: "Bolivia is constituted in a Social Unitary State [...] Plurinational [...] intercultural, decentralised and with autonomies". This implies the adoption of a "new model of territorial State" that is more in line with the "model of Plurinational State" enshrined in the Constitution. Strictly speaking, it means that Bolivia must undertake a *serious* transition from "a centralised neo-liberal Unitary State" inherited from the 19th century, typical of the initial uniform liberalism of that period (García Linera, 2010, pp. 39-52), to a *decentralised* (unitary) State more in line with the distribution of political power that gained strength as a democratising element in the last quarter of the 20th century. Part Three of the PCS (Territorial Structure and Organisation of the State) is dedicated to this question. Clearly, it is a cornerstone of the Constitution.

The territorial model of "State of Autonomies" adopted by Bolivia is rooted in Article 269.I PCS, which defines the territorial framework of the State in terms of national plurality. The PCS stipulates that "Bolivia is organised territorially into departments, provinces, municipalities and indigenous farmer territories". Said territorial departments or "territorial units" (as they are called in Article 269.II PCS) are created, modified and delimited by the democratic will of their inhabitants, pursuant to the terms and conditions stipulated in the Constitution and the law.

The Constitution and Law No 31, of the 19th of July 2010, the "Andrés Bónifaz" Framework Law on the Autonomies and Decentralisation (hereinafter referred to as the FLAD), guarantees and

implements the four levels of Bolivia's State of Autonomies: the *Departmental*, *Regional*, *Municipal*, and *Indigenous Farmer* levels. The autonomous and regional departments and the autonomies of the indigenous originary farmer nations and people may come under a *Statute of Autonomy*, whereas the municipalities base their autonomy on an *Organic Charter*. All of these come under the framework of the Constitution.

From a material standpoint, the functions of government authority, decentralisation of political power and setting up a multi-level government in Bolivia is organised according to the distribution of competences stipulated in the Constitution and assumed by the central government and autonomic bodies (Morales Olivera, 2010, pp. 559-567).

The PCS classifies the competences into four different types (Articles 297-305 PCS): "Prerogative" (competences of the central level of State, which cannot be transferred or delegated); "exclusive" (pertaining to certain areas of the central and autonomic governments that can be transferred and delegated); "concurrent" competences exercised in parallel by the State and the autonomic bodies; and "shared" by the State (basic legislation) and the autonomic bodies (implementing legislation). In all, the PCS (February 2009) recognises 56 competences for the decentralised autonomous bodies (36 exclusive and 23 concurrent and shared competences). However, the FLAD extended the list by adding 50 new competences for the decentralised bodies in July 2010.

C) *National Plurality in the Justice Model.*

Here I refer to the constitutional norms that institutionalise national plurality in the State legal system and the constitutional legal system. The most important impact of national plurality on the legal system is the constitutional principle of "legal pluralism"; the institutionalisation of a justice system based on national plurality; and the legal operators' obligation to integrate "interculturality" as a criterion for interpreting legal norms (Rodríguez Veltzé, 2010, pp. 425-433).

Legal pluralism is stipulated in Article 1 of the PCS: "Bolivia is constituted in a Social Unitary State of Plurinational Communitarian Law, free, independent, sovereign, democratic, intercultural, decentralised and with autonomies. Bolivia is founded on plurality and on political, economic, legal, cultural and linguistic pluralism, within the integrating process of the country". Legal pluralism is also stipulated in Article 179.I PCS, which states that although Bolivia has a single legal system, there are several jurisdictions within it, all on the same hierarchical level: ordinary, agro-environmental, specialised, and the indigenous farmer jurisdiction (which is exercised by their own authorities, elected according to their uses and customs, and with their own institutional rules of procedure).

Strictly speaking, Bolivia has "one" unitary legal system, although it comprises several jurisdictions at the same hierarchical level of importance. In this respect, legal pluralism (in the shape of several jurisdictions) operates at a "sub-constitutional level". However, at constitutional level, Bolivia has a single legal system with the constitutional justice system at the apex, represented by a catalogue of fundamental rights that are recognised in the PCS. Therefore, the task of standardising and giving coherence to Bolivia's legal system is underpinned, in last instance, by the case-law emanating from the Plurinational Constitutional Court (PCC). The seven magistrates who make up the CCP's constitutional justice system are elected according to universal suffrage by a plural civilian society. This should facilitate the indigenous farmer nations and people's access to the highest body of the constitutional justice, although the law ensures the presence of at least two of them. Obviously, the PCC is the most important of all Bolivia's government institutions, after the Plurinational Legislative Assembly. Undoubtedly it will play a decisive role in building and consolidating the country's renewal.

D) *National Plurality in the Social and Economic Model.*

This expression of national plurality is related to the constitutional norms that institutionalise national plurality at the social and economic level. In other words, the "communitarian economy" is the typical and habitual method of economic production of the indigenous originary farmer nations and people. The fact that the PCS *attributes value* to the communitarian economy as part of the *content* of the plural economic (and social) model means setting up a plurinational social State in Bolivia based on the core notion of the common "good life".

It should be borne in mind that national plurality also affects the social model established by the Constitution of 2009 by defining the notion of "plural economy" as a *specific component* of Bolivia's Plurinational State. It is a specific component that requires "building a paradigm of the good life" for the community as a whole (Montero Justiniano, 2010, pp. 592-593).

The impact of national plurality on the social model defined by the notion of the "good life" makes sense in the light of the intimate connection between the following four factors: the population's *cultural diversity*; the effective *limited extension* of the rights of people who are cultural *different* than the majority (i.e. members of the indigenous originary farmer nations and people); the indigenous peoples' very limited *effective enjoyment* of the benefits of the State's public services (Del Real Alcalá, 2008, pp. 569-588); and the attribution of (public) "value" to the indigenous originary farmer nations and peoples' traditional models of economic management.

Several constitutional norms itemise what constitutes *social and economic national plurality*. Thus, Article 306.I and II PCS recognise the indigenous peoples' "communitarian economy" as part of the good life economy within the country's economic organisation and an integral part of the latter: The Bolivian economic model is plural and seeks to improve the quality of life and good life of all Bolivians". Paragraph II provides constitutional protection for the "plural economy" "constituted by forms of communitarian economic organisation" that "complete" the collective good life. Thus, a close link is established between the economy of indigenous people and the "economic model of the good life" (Article 313 PCS). The Constitution (Article 307 PCS) ensures that "The State will recognise, respect, protect and promote communitarian economic organisation" consisting in "the systems of production and reproduction of public life, founded on the principles and visions of the indigenous farmer nations and people".

Thus, the Bolivian State, based on the PCS, is conceived to include a "plural economic order" that integrates a *social market economy* and a *communitarian economy*.

Conclusion: the Inclusion of National Plurality as one of the Most Transcendent Moral, Political and Legal Values of the Fundamental Law

In conclusion, Bolivia's Constitution of 2009 raises national plurality to the status of a "basic founding fact" that underpins the country's renewal. More precisely, the country is reshaped as a "Plurinational State". Moreover, Bolivia's new constitution establishes a close connection between the model of *Plurinational State* and *social* model to which it aspires, in terms of structure and objectives. They are both presented as essential models in modern Bolivia.

In any event, it is worth stressing the fact that Bolivia's Constitution of 2009 is not just one more constitution in the Andean country's history. Quite to the contrary, it represents a historical change in Bolivia; a task that involves two types of profound changes in the State's framework that were never attempted before: a shift from the former republican *Jacobin* State (Del Real Alcalá, 2004, pp. 307-340; and 2007b, pp. 165-203) to a "plurinational *State*"; and a shift from the former *neoliberal* State to a "*social State*" based on the constitutional notion of a collective "good life". Because it involves far-reaching change, it could be asserted that Bolivia's Constitutional of 2009 causes the "re-founding" of Bolivia as a country. It is a highly laudable task on a titanic scale that is fraught with difficulties. We can only wish the Bolivians the best of luck.

The 2009 Constitution builds a new Constitutional State model based on elements of modern constitutionalism (Asís Roig, 1999). National plurality is a *core, foundational, mainstreaming-institutional* value in the Constitution of 2009 and the model of State it establishes. Protecting it should be a prime endeavour of Bolivia's authorities and every political and judicial decision-maker in the country, and of the social and economic agents as well.

It is true that the country has the appropriate legal and constitutional mechanisms and with the institutions *of its time* (Bobbio, 1991) to undertake the task, but the Plurinational Constitutional Court will undoubtedly play a significant role in protecting the moral, political and legal value of national plurality. Furthermore, the PCC must ensure that the numerous constitutional expressions of national plurality in every field are not infringed in their enactment, execution and interpretation.

It should be borne in mind that due to the way the PCS is structured, infringing national plurality would mean a violation of the spirit of the Constitution and the intercultural, social and decentralised State chosen by the people of Bolivia in democratic elections. It is they who decided to give institutional substance to the Plurinational State of Bolivia, as their country is officially known.

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MUSLIMS AND VIOLENCE

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Abstract:

This paper tries to explain the relationship between Muslims' problems and violence in the light of a clear distinction between Islam and Islamic political thought.

This research emphasizes on the fact that Koran and Sunnah aim at guiding mankind to the right path of knowing and worshipping God; they are not political treatises; Islam could live without a Muslim State even before the instauration of the prophet's State; nowadays, millions of Muslims live under the rule of non Muslim governments or Muslim governments that do not enforce the Islamic law, yet Islam continues to flourish; hence, no Islamic political thought, albeit useful and justified at a certain time, place, or circumstances is to be sanctified because that will certainly lead to a political blockage which could yield violence.

Key Words: Islam, Islamism, Muslims, violence

Introduction

Writings about a potential relationship between Islam and violence are abundant whether in the Muslim world or in the Occident. Islam is a fast growing religion but certainly not because of violence or constraint. On the other hand, Muslims are suffering from a multitude of crises, especially internal factions between Sunnis and Shiites, struggles for power, tyranny, conflicts with other religions and civilizations...

Some Islamists resort to violence to solve these problems on the basis of thoughts or theories they, somehow, relate to Islam.

This paper tries to explain the relationship between Muslims' problems and violence in the light of a clear distinction between Islam and Islamic political thought.

In order to attain the above mentioned aim, the two following points should be considered.

- The evolution of Islamic political thought in order to discern limpud Revelation from human thoughts or practices.
- The political blockage in the Muslim World in respect of power alternation and power organization.

Evolution of Islamic Political Thought

In this section, we will emphasize two points to shed necessary light on the evolution of Islamic political thought: power investiture and power organization. The mechanism of access to power is assumed to be the primordial rule of constitutional law¹; therefore, it can help detect the genuine sense of political legitimacy in Islam; this could be attained by examining the initial political debates and writings therein.

The way in which power is organized can also illuminate us about the political genius of Muslims in State constitution. These two points are to be pinpointed all through this section in order to explain, in their light, the present Islamic political blockage in the following section.

Before tracking these two parameters, we should, initially, determine the scope of Islamic political thought to delimitate the field of research.

¹ F. Z., La naissance du droit constitutionnel, in *Kuwait Journal of Law*, Vol. 3, Septembre 2009, pp. 14-15.

Scope of Islamic Political Thought

Concepts can have various definitions, especially in human sciences, and this may lead to confusion and ambiguity; therefore and in accordance with the aim of this paper, it would be useful not to give different and even contradictory definitions to Islamic political thought; instead, it would be better to limit its scope in order to discern what is not Islamic within the field of political thought. To this end, two determinants are to be used; the first concerns the sources of Islamic political thought and the other has to do with the thinker.

As concerns the first question, Islamic political thinking derives from two major sources, namely: the holy book of Muslims (Koran) and the Muslims prophet's sayings and conduct or his approbation of Muslims' sayings or conduct (Sunnah); any political thought that contradicts these two major sources is not to be considered a Muslim thought, but an illegal innovation (Bid'ā); on the other hand, this does not mean not to refer to other sources on condition not to contradict Koran or Sunnah.

As for the second question, it should also be said that Islamic political thinking, as is the case with Islamic thinking in general, must be conducted by a Muslim scholar else it is not to be qualified " Islamic " unless adopted by a Muslim scholar.

According to what has been said and within the field of politics, Islamic political thought is the outcome of a thinking process conducted or adopted by a Muslim scholar on the basis of sources that do not contradict Koran or Sunnah.

First seeds of Islamic political discussions

The very beginning of Muslim society and State goes back to the year 622 after the migration of the Muslim's prophet and some of his companions from Mecca to Medina where the prophet established the first Muslim State. After ten years, the entire Arabic peninsula adopted Islam and became part of the Muslim State². At this point no one could claim power since religious and political power was vested in the Prophet by Allah.

After the death of the prophet in 632, some Arab tribes tried to live outside the Muslim state as a sort of denial of any political authority other than that of the prophet's; therefore, started the wars of apostasy for different pretexts: some Muslims argued about who deserves to succeed the prophet in political power, others rejected the Caliph's authority to collect the alms giving (Zakāt), a third category admired the prophet as a man and could not accept the authority of the Caliph Abu-Bakr or any one else . In order to cut down this civil strife, the Caliph declared war on the apostates. Shafi'i, an eminent Muslim scholar, approved this stand assimilating it to other high crimes in Islam saying that: " ... duty imposed on us to punish the fornicator with a hundred stripes, to scourge him who casts an imputation with eighty, to put to death him who apostatizes...³."

The Caliph Abu-Bakr was chosen by few Muslims during a meeting between the original inhabitants of Medina (Al Ansār) and the Migrants (Al Muhadjirine); the formers wanted to chose one of them as a successor of the prophet; when the Migrants heard about this meeting, some of them rushed to prevent them from making any hastened decision. After debating the matter, all agreed on choosing Abu Bakr, then the rest of the Muslims submitted to the choice of their elite and presented their allegiance to the successor of the prophet. After his death, he proposed Umar ibn Al Khattāb to succeed him and the Muslims submitted to his will. In his turn, Umar chose six of the senior companions as a small committee to elect his successor amongst them and thus Uthmān ibn Affān was the third to hold the office of the Caliphate. After his assassination, a big civil strife took place and blood was shed for the first time between Muslims: the supporters of the fourth Caliph, Ali ibn Abi Talib, who claimed that taking revenge of the assassins of Uthman would lead to civil strife, and the supporters of Muāwiya ibn Abi Sufiāne who believed that justice should be done and therefore claimed the command of the Muslims to fulfill his objective⁴.

² Bessam Jarār, *Dirāsāt Fy al-Fikr al-Islāmy* (Studies in Islamic Thought), Nūne Centre for Koranic studies and research, El Bīra , Palestine, 2nd Ed., 2006, pp. 15, 16.

³ Al-Shafi'i, *Treatise on the Foundations of Islamic Jurisprudence*, translated by Majid Khadduri, Cambridge, UK: The Islamic Texts Society, 2nd Edition, 1987, pp. 247-290.

⁴ Ahmet Turān, *Les premières dissidences dans l'Islam et la naissance des différentes sectes* [on line], http://dergi.samsunilahiyat.com/Makaleler/1303285882_199307040282.pdf

What can be noticed here is that alternation of power had become more and more violent after the death of the third Caliph; this could be explained by the personality of the first four Caliphs who were deemed to be the most pious among the prophet's companions.

As for the organization of power, it was centralized in the hands of the Caliph as a religious and political leader who appointed a governor (Wāli) for each province under his direct command.

Total and unconditioned allegiance to the Caliphs facilitated the management of the State affairs and raised no serious problem to the centralized government. On the other hand, new mechanisms were invented to ensure security and welfare of the Muslims especially during the reign of Umar ibn Alkhattāb who, for example, established an organized financial accountability so as he could detect a mere deficit of one " Dirham " (one currency unit)⁵.

Many of the general political principles decreed by Koran and Sunnah, were theoretically detailed and practically crystallized during the reign of the caliphs via the practice of Consultation (Shūra) of the senior companions in the management of governance: administration, judicial, financial, military... as well as in inferring the legal solutions to everyday problems. Till this point, political debates focused on the choice of the Caliph and then on how to manage the Caliphate. After the reign of the fourth Caliph, Ali ibn Abi Talib, the Islamic State witnessed a major change as for the mechanism of access to power for Muāwiya made of the command of the Muslims an inherited monarchy and thus closed a major door of political debate. This practice marked a stain in the Islamic political history and became a tradition in denying the will of the Muslims throughout the following ages.

As for the organization of the State during the Umayyad reign (661-750), the bureaucracy had witnessed an adulcorated centralization because of two facts, the first is the expansion of the Islamic State that reached its apogee during the reign of the Umayyad and hence tempted some powerful governors to rebel against the power of the Caliph as did Abdurrahman ibn al Ash'ath; the other fact is that the middle class, from which should derive the support of the Caliphate, lost its power in favor of clients (Mawāli), powerful governors, army commanders and their relatives⁶.

The expansion of the State had created a multicultural context that influenced Muslim scholars to be in contact with foreign political thought and practice, hence started an important wave of political writings.

First Islamic political writings

During the Umayyad reign, a very active movement of translation emerged and marked that era; many political writings were translated from Greek, Latin and Persian; Abdullah ibn Almuḳaffā is known to be a pioneer in this field; one of his master pieces is " Kalila wa Dimna " (Kalila and Dimna) which he translated from Persian to Arabic; he also wrote a famous book entitled : " Risalāt Assahāba Namuthajan " (The Message of the Companions as a Model) in which he tried to prove that the Islamic State was not only based on Revelation but also on cerebration⁷. What is to note here is that the Umayyad Monarchs were very much influenced by these writings to an extent that some scholars could say that their political regime was an imitation of the Persian and Byzantine regimes⁸.

Could it be said that the Islamic political thought was only a refraction of foreign writings? The answer is certainly negative because the Islamic doctrine, due to civil strifes and political switch from Caliphate to Monarchy, treated three main political questions, namely: the legitimate access to power, allegiance and the possibility to rebel against the corrupt ruler⁹. An Umayyad Monarch called " Umar ibn Abdelazīz " crystallized the theoretical reforms proposed by prominent scholars like " Sa'īd ibn Elmusaḳab ", Sa'īd ibn Jubayr " and " Alhassan Albasri " and redirected the State once again into the path of the four Rightly Guided Caliphs and that is why he was nicknamed " The Fifth Rightly Guided Caliph ". Nevertheless, these doctrinal questions were not treated as an independent discipline; they were scattered in doctrinal books until the end of the Umayyad rule and the beginning

⁵ for more details see for example, Mahmūd Al Mursi Lashine, *Altanthīm Almuḳasabi Lila'muāl Al'āma* (Accounting Organization of Public Funds), Beirut, Dār al-Kitāb al-Lubnāny Liltībā'h Wālnashr Wāltawzy', 1977.

⁶ Roberto Marin Guzman, Arab Tribes, the Umayyad Dynasty and the Abbasid Revolution, in *The American Journal of Islamic Social Sciences*, Vol. 24, Nr. 4, pp. 66-67.

⁷ Erwin Rosenthal, The role of the State in Islam: Theory and Medieval Practice, in *Islam*, Vol. 50, 1973, pp.25-28.

⁸ Muhammad Jalāl Abul Futūh Sharaf & Ali Abdel Mu'tī Muhammad, *Political Thought in Islam*, Alexandria, Dar Al Ma'rifa Al Jami'ia, 1987, p. 125.

⁹ Idem.

of the Abbasid's; then political writings started to crystallize independently with the four great Muslim scholars: Abu Hanīfa Nu'mān (699-767), Mālik ibn Anas (711-795), Al Shafī'i (767-820) and Ahmad ibn Hanbal (780-855)¹⁰.

During two centuries, the Islamic political writings developed increasingly due to the accumulated experience of the Islamic State, the benefit from political thought and experience of other civilizations and doctrinal prosperity during the Umayyad and Abbasid reign. The Islamic political writings followed four different methods: one way is to dedicate separate chapters for questions related to State management within general doctrinal works as " Al Um " (The Mother), by Shafī'i, is an example ; the second method is to relate political subjects with a particular legal issue such as State finances as did Abu Yūsef (732-798), one of Abu Hanīfa' s students, in his book " Alkharadj " (Imposition) ; a third method is to devote a whole treatise to only political issues as is the case of " Al Ahkām Alsultānia " (The Sultanic Rulings) of Al-Māwardi (975-1058); the last method is to dedicate a whole treatise to a particular political issue such as " Alnidham Al Mali lildawla " (The Financial regime of the State) of Abu Ubeid Al Kacim ibn Salām (770-838)¹¹.

The Political Blockage in the Muslim World

This section deals with the main causes behind the present political blockage in the light of the two above-mentioned parameters, namely: power alternation and power organization.

Most rulers in the Muslim World are facing a double challenge: a severe crisis of legitimacy and an undeniable failure in managing State affairs. As for Muslim Scholars, many of them are imprisoned in the past from two points of view: they tend to resort to old fashioned thoughts in dealing with contemporary political problems in disregard of historical contexts and they confront religion with philosophy in block without deciphering the scopes of Revelation and cerebration.

Crisis of Legitimacy

Most of the Muslim World countries are suffering from a severe crisis of legitimacy; instead of seeking innovative solutions that respect Koran and Sunnah and benefit from the human intellectual heritage and successful experiences of other societies, many Muslim scholars drown in past conflicts and revive them in the present whether by nostalgia, hopelessness or to serve a certain political agenda as is the case of the permanent conflict between Sunnis and Shiites about who better deserved " Imāma " (Religious and Political Leadership of the Muslims), Ali or his three predecessors : Abu Bakr, Umar and Uthman !? Meanwhile, those in power find this perpetual sterile arguing a successful distraction from being asked to justify their rule.

As far as the issue of Imāma is concerned , Abu al-Hassan Ali ibn Ismā'īl al-Ash'arī (874–936) is considered to be the most influential scholar in the Sunni school since he relied on revealed texts, after the fashion of the Shiites, to establish the proof of Abu Bakr' s legitimate reign¹²; this method inspired the majority of Muslim scholars to rely on Koran and Sunnah to find legal explanations to historical facts¹³.

The eternal conflict between Sunnis and Shiites, for example, has enrooted hatred between Muslims of the two sects and gave way to translating political differences into violent clashes as it is happening in Iraq. The arguing is still going on for different reasons that have nothing to do with the essence of Islam. The nostalgic reasoning that aims at reviving the Muslim Empire to stand sturdy in front of the Occident is but a deformation of limpid Revelation; whereas, freedom of ideology and religion, assisted by peaceful and orderly means of practice and expression, is necessary for healthy, stable, expanding, and progressive societies whether in dealing with internal or foreign affairs¹⁴.

¹⁰ Al Intisar, Les différentes écoles juridiques [on line]

<http://alfatihoun.edaama.org/Fathul%20Moubin/FathulMoubin/Fiqh/Madhhab.html>

¹¹ Uthman Muhammad Fathi, *Min Usūl Al Fikr Essiyassi Al Islāmi* (From the Fundamentals of Islamic Political Thought), Beirut, Rissāla, 1979, pp. 32-34.

¹² Abu al-Hassan Ali ibn Ismā'īl al-Ash'arī, *Al-Ibānāh Fi Usul ad-Dyānāh* (Clarification in the Fundamentals of Religion), Misr, Dār al-Ansār, 1977, p.251.

¹³ Abdulhamīd Al Kattani, *Nidhām Alhukuma Alnabawiya Almusamma Biltarātīb Alidāria* (The Regime of Prophetic Government called Administrative Arrangements), Beirut, Dar Alkitāb Al-lubnāni, Vol. 1, p. 3.

¹⁴ Uthman Muhammad Fathi, op.cit. p. 100.

The Limpid Revelation teaches us that God created people different and they will remain so¹⁵; they are meant to know each other through wise dialogue and not to interpret their differences into a desire to destroy each other; on the contrary, this is a flagrant disrespect of Revelation. Most causes of violence between Muslims or between them and other nations have nothing to do with brotherhood in Islam or tolerance; they either spring from narrow mindedness or serve a particular political agenda.

Failure in Performance

Theoretically, the aim of the Muslim State is to provide for the basic individual and collective needs; Sheikh Al-Shātibi, who died in 1388, would call those basic needs "Necessities" which are indispensable for the well being of Muslims in this world and hereafter¹⁶. These aims can be summarized into five: preservation of Deen (religion), Aql (intellect), Nafs (life), Mal (property) and Irdh (dignity)¹⁷. These aims cover the different aspects of life according to Muslim scholars and, thus, need complex and effective bureaucracy to fulfill them.

Most States in the Muslim world have poor political institutions that can take in charge the different aspects of life; therefore, the success of an economic pattern, for example, depends greatly on the personal qualities of the leader than an institutional organization; the United Arab Emirates is a striking example in this respect. With the exception of the Iranian complex effective institutions, Some researchers in the field of Islamic political thought, are astonished by the flimsy Islamists' vision of political institutions though they put great emphasis on politics in Islam or what they call "Political Islam"¹⁸.

Power organization in many Muslim States is either weak or ineffective because it is either based on autocratic rule in which all the political decisions are enacted by the autocrat or based on a fake democracy that relies on institutions similar to western democracies with no real power; most Arab countries can be taken as examples in this regard, such as Algeria, Tunisia, Egypt, Syria...

The lack of a clear institutional vision may be the very cause of the failure in performance by many governments in the Muslim World; in juridical terms, these governments do not possess real constitutions that organize and limit power because a real constitution strikes a balance between liberty and power in accordance with the identity of each society; this is achieved by establishing a body of institutions with coherent competences to guarantee stability and by creating practical mechanisms to make sure that liberties are not violated. With the exception of rare successful Muslim States, studies demonstrating many features of failure: poverty, diseases, analphabetism... are abundant¹⁹.

Conclusion

The aim of this essay is to try to explain the causes of Islamic political blockage and its relationship with violence relying on an impartial discussion of two sensitive issues in the Muslim World: Imāma and power organization.

In the following points, it is made clear that Limpid Revelation is a great source of intellectual guidance and freedom; our understanding of this Revelation depends on time, place and circumstances and these are undoubtedly variable; whereas, Revelation remains valid for all times and places.

First, it should be pointed out that the Holy Koran and the True Sunnah do not contain **conclusive provisions** about :

1. Imāma; no one can claim in the name of God that Muslims' political and spiritual leadership is inherent to a particular person; the prophet ruled the Muslims on the basis of Revelation; when he died, Revelation would not serve as a source of legitimacy to anyone else; using analogy to prove someone's merit of Imāma is inappropriate because no Muslim dares to claim the prophet's religious and political status. As a result, Islam is open to the human

¹⁵ Koran, Chapter 11 (HUD): " If thy Lord had so willed, He could have made mankind one People: but they will not cease to dispute, except those on whom thy Lord hath bestowed His Mercy: and for this did He create them: and the Word of thy Lord shall be fulfilled "

¹⁶ Abdīn Ahmad Salāma, *Tawfīr Alhadjat Al-Asasiya Fi Dhil Al-Dawla Al-Islamiya* (Providing Basic Needs Under the Reign of the Muslim State), in *Abhath Al-Iktisād Al-Islami Journal* , Vol. 1, Issue 2, 1987, p. 62.

¹⁷ <http://www.daralhijrah.com/SJ/Vol.%201%20Isu.%201.pdf>

¹⁸ Olivier Roy & Carol Volk, *The failure of political Islam*, Harvard University Press, pp. 168-175.

¹⁹ see for example : *Zaghlūl Al-Nadjār, qadhiat al-takhaluf al-Ilmi wal-tiqni fil-Ālam Al-Islami Al Muāṣar* (The Issue of Scientific and technical underdevelopment in the Contemporary Islamic World), Cairo, Maktabat wahba, 2006, pp. 6-13

intellect to determine the source of political legitimacy in concordance with particularities of time and place; what matters is the real contentment of Muslims with the source of legitimacy of their rulers which makes them real citizens and not mere subjects. Furthermore, a consensus of all Muslims on a certain thought or theory about the source of legitimacy is unattainable; this makes the plurality of Muslim States plausible; whereas, imposing a single State to gather all Muslims, on the basis of religious obligation or necessity, could incite internal factions as happened during the reign of the fourth rightly guided Caliph, Ali. In addition, even with multiple Muslim States, the accumulation of Muslims' spiritual and political leadership in one person is neither a religious obligation nor a necessity; on this basis, political leadership can be vested in State rulers and spiritual leadership can be the duty of Muslim scholars. As for the political leadership, autocracy is not taken for granted to realize Muslims' unity; so the choice of presidential, parliamentary, assembly government system or any other hybrid regime is a matter of adequacy; i.e., how adequate the organization of power in fulfilling the aims of the State, especially the five aims of the Islamic law "Shari'a": preservation of religion, life, intellect, dignity and property.

2. the technique of access to power; otherwise, the prophet would have been the most qualified to set a mechanism of power alternation as a tradition to Muslims; hence, Muslims are free to choose any mechanism of access to power that concords with the source of legitimacy they adopt and in accordance with the principle of "Shūra" (Consultation) that should be observed in choosing rulers and in managing state affairs.

Second, within the fundamentals of Islam, notably the six pillars of faith; namely, belief in God, in angels, in holy scriptures, in the prophets, in life after death and in divine decree, the different opinions concerning political issues such as the source of legitimacy, mechanisms of power alternation and power organization resulting from different interpretations of Koran and True Sunnah enrich the political jurisprudence, but no one can claim holding a unique absolute truth. For example, the differences between Shiites and Sunnis about Imāma can be accepted as a political divergence, but both of them cannot pretend monopolizing truth even if both parties scrutinize Koran and Sunnah to give some texts certain interpretations to sustain their claims.

Third, in regard to relations with non Muslims, Islam neither ordain nor recommend Muslim States or Muslims, as individuals or groups, to convince non Muslims with Islam via violence; on the contrary, this is explicitly and strictly forbidden on the basis of the five above mentioned aims of Shari'a . Therefore, what some would call conflict of religions is rather a result of misunderstanding Koran and Sunnah.

Forth, the field of Islamic political thought is wide enough to find solutions to political problems without inciting to violence; Muslim scholars are free to use cerebration and to benefit from non Muslims' findings since they do not violate Koran and True Sunnah ; in addition, a line should be traced between conclusive and inconclusive provisions in these two sources so as to widen the field of interpretation of texts in respect of time, place and circumstances; thus, Islamic and appropriate solutions can be reached .

Finally, Koran and Sunnah aim at guiding mankind to the right path of knowing and worshipping God; they are not political treatises; Islam could live without a Muslim State even before the instauration of the prophet's State; nowadays, millions of Muslims live under the rule of non Muslim governments or Muslim governments that do not enforce the Islamic law, yet Islam continues to flourish; hence, no Islamic political thought, albeit useful and justified at a certain time, place, or circumstances is to be sanctified because that will certainly lead to a political blockage which could yield violence.

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FORMALIZATION OF MARKETING AND FINANCE MANAGEMENT INTERFACE

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Abstract:

Actually, in the theory of company's finance management and marketing is more often acknowledged that marketing activity create company's financial value, however in practice it is complicated to value the contribution of marketing in creating firm value and substantiate marketing investments in the viewpoint of value based management. In this article attempts are made to formalize the impact of marketing/finances management systems interface for firm value. The scientific problem handled in the article is defined as following: formalization of marketing/finance management systems interface impact to the firm value. The purpose is using mathematical logic carry out comparative analysis of theoretical models as well as empirical investigations, analyzing interface of marketing and finance management from the viewpoint of firm value.

Theoretical interpretation of marketing/finance management systems interface as well as its effect for firm value has been presented, basing on which the main contact points of marketing and finance management systems are highlighted. Two dominant business objectives: establishing competitive advantage and creating shareholder value, are not conflicting rather equivalent objectives originating from a single economic framework. Comparative analysis of models investigating the effect of marketing decisions to firm value has been performed-it singled out the relationship between market-based assets and cash flow as the main connecting-link in creation of marketing decisions and firm value.

Key Words: Marketing and finance interface, shareholder value, value based management

Introduction

In the environment of growing competition the greater importance creation firm value is attributed to intangible company assets, among which is the assets created by marketing (market-based assets), for instance, brand, relations with customers, etc. That is why a very complicated scientific problem for nowadays researchers is how to estimate that contribution of company and its systems work which create intangible assets and their performance are difficult to value by financials indicators, i.e. to express in monetary units. The interface of marketing and financial management systems in the context of firm value creation using different theoretical aspects were researched by different scientists: Srivastana, Shervani, Fahey, Doyle and others. Nobody questions the truth about the use and value of marketing decisions, aiming at this financial purpose, that is creation firm value, but there is still a lack of thorough explanation and investigation mechanisms of this relationship of marketing and firm value. It is important to conceive, formalize and base, how financial firm value creation concept principles can be related to strategic marketing decisions, and in what way strategic marketing decisions and the intangible assets created by them participate in increasing financial value. That is why in this article attempts are made to formalize the impact of marketing/finances management systems interface for firm value. Consequently, the scientific problem handled in the article is defined as following: formalization of marketing/finance management systems interface impact to the firm value. The object of research is marketing/finance management systems interface. Thus, the purpose is using mathematical logic carry out comparative analysis of theoretical models as well as empirical investigations, analyzing interface of marketing

and finance management from the viewpoint of firm value. In the article, using mathematical logic while systemizing and comparing the main ideas of the scientific research, is analyzed the variety of interface theoretical models of company marketing and finance management systems as well as the level of the empirical research and substantiating of this interface co-relation. Conceptual essence of company's marketing and finance management systems interface are investigated, rendering theoretical background for conception of value and obtaining the link between sustainable competitive advantage and firm value creation. Generalizing, the main theories and conceptions as well as their contact points analyzing this interface, are presented.

Main research directions of marketing and financial management interface

In the course of history the role of marketing and financial management in the company has changed, today main goal of the company's value maximization that covers all company's goals emphasizes the importance of concord between marketing and financial management in the company. However, now it is possible to distinguish four research groups of different views.

First view claims that for a long time the theoreticians and practitioners of marketing have held the view that the customer's value naturally determines the shareholder's value (Day and Fahey, 1988), and the financial ones – took a different attitude (second one) which claimed that focusing on the maximization of the shareholder's welfare almost automatically impels to please the customer (Reiman, 1989, Rappaport, 1998). Moreover, social responsibility theory (the third one) criticized both previously mentioned views (Luo and Bhattacharya, 2009). The third view claims that the company has social commitments as well and that beside the shareholder or customer in business there are other stakeholders: employees, suppliers, society. It is being argued that executives tend to ignore other social responsibilities in order to maximize the value of the shareholder or customer, and so they lose the balance regarding the interest of different stakeholders. The fourth view studies the interface of marketing/financial management by trying to combine the positions of the shareholder and the customer (Srivastava, Shervani, Fahey, 1997; 1998; 1999) If placed in formulas these four main views could be expressed as provided below:

- 1) Traditional marketing point of view: $\square p \square a$
- 2) Traditional financial management point of view: $\square a \square p$
- 3) Social responsibility theory view: $\forall a \rightarrow (p \cdot t \cdot d \cdot b)$

4) The interface of marketing/finance management is analyzed in the sense of compatibility between customer's and shareholder's value: $(\square a \square p) \square k$

here: p – customer's value; a – shareholder's value (company value); k – competitive advantage; d – value of the employees; t – supplier's value; b – society value; “ \square ” (dot) – conjunction; “ \rightarrow ” – contradiction; “ \forall ” – implication; \square – existence quantifier; \square – unity quantifier.

Traditional marketing position regarding the augmentation of the company's value has been developed while creating many sorts of “the best/universal” strategy, for example Hammer and Champy “Reengineering the corporation” and other. That has significantly emphasized the importance of symbiotic relations between the strategy creation and evaluation. During the recent year a major part of the business strategy works have had been shaping up a strategy, predicted the advantages it might create but has not shown why these results should significantly increase the company's value.

Some authors claimed that these inferences are indisputable; therefore the analysis of company's value is not necessary. This claim could be expressed as follows: $\square (p \square k) \square a$. However, as confirmed by practice the outcomes of the value creation strategy are not always so obvious. The company's value will materialize only when the customers will be ready to pay the incurred costs.

The traditional financial management view had been developed in the works of value based management, which basically analyzed the problems of value measuring instead of its creation. The core assumption of this philosophy is that: the main obligation of the executives is to create shareholder wealth. It is possible to distinguish three stages of value management development: the creation of calculation models for business value estimation is the more characteristic of the first stage; at the second stage attention to the strategic point of view became more prominent; the third (current) stage of integration analyzes company's value in a broader and more holistic view (Morin and Jarrell, 2001). Most recent works on the concepts of company's value estimation next to the financial strategy emphasize the importance of marketing strategy to the value creation. It is stated

that without forward shaping and development of an original marketing strategy methods of company value estimation are just simple calculations. It has been agreed that the objectives of winning competitive advantage and of company value creation do not contradict each other but are equivalent. In mathematical logic this claim is expressed as follows: ($a \square k$), here: " \square " – equality status. Though in these works the importance of original marketing strategy is already being emphasized and the influence of marketing and financial activity to the value factors is shown as well, the management solutions for marketing and financial management interaction are not being actualized.

The attitude of social responsibility theory are revealed through various models (for example: EFQM, The Balanced Scorecard and other) analysing the interrelations between the company's employees, customers and financial results as well as evaluates different aspects of the company's performance. In models based on social responsibility theory company's performance are being equally evaluated by the attitude of customers, employees and shareholders, though some of them are only a measurement system for achievements, others indicate interrelations and the third group attempts to determine the reasons. In this case the main problem is that so many goals can lead to confusion and making of bad decisions. Besides, these models are very clumsy, complicated and subjective.

In order to maximize the company's value, while analyzing the main researches on marketing and financial management interface it is possible to classify them into three groups: empirical research of how various marketing elements influence the company's value, theoretical models of finance and accounting intangible asset evaluation methodic, and theoretical models of marketing and financial management integration.

Attention to the role of marketing in the process of company's value creation is relatively minor in the literature about marketing. It is possible to distinguish research of the event which relates the "event" such as for example: launching of a new product, with an uncharacteristic change of the company's stocks prices. Also, an important part of literature (e.g. PIMS project) connects such marketing elements as consumer satisfaction, brand and quality, parts of market with various measures of estimating the changes in business results, such as profit and investment revenue, cost of capital (Luo, 2008; Tipton, Bharadwaj, Robertson, 2009; Luo, Homburg, Wieseke, 2010; Joshi, Hanssens, 2010; Bharadwaj, Tuli, Bonfrer, 2011; Kim, McAlister, 2011; Rego, Billet, Morgan, 2011; Mintz, Currin, 2013). These studies do not evaluate how marketing activity influences the company's value, but they prove the marketing activity's importance to the maximization of the company's value.

It could be stated that in parallel financial literature ignored marketing activity's contribution to the process of company's value creation, except for the suggested variety of methods for financial accounting assets evaluation, which attempts to evaluate even the intangible assets (including the intangible assets created by marketing) (Reilly, Schweihs, 1994; Anderssen, Tissen, 2000; Tissen, Anderssen, Deprez, 2000; Wiesel, Bernd, Julian, 2008; El-Tawy, Tollington, 2008). Both in theory and practice it is accepted that company's results tend to increasingly depend on the intangible assets of the company, such as company's culture, relationships with customers, brand value, etc. The variety of methods for evaluation of the intangible assets verifies both: the importance of this problem as well as the challenge of evaluation.

A deeper insight into this problem is given in the third theoretical research direction – theoretical models which investigate the intangible assets created by marketing as a source of company's value creation (Glazer, 1991; Feurer, Chaharbaghi, 1994; Slywotzky, 1996; Cleland, Bruno, 1996; Srivastava, Shervani, Fahey, 1997, 1998, 1999, ; Walters, Halliday, 1997; Doyle, 2001):

$A = \langle M, V \rangle$, when $M = f(p, m_1, m_2, \dots, m_n)$; $V = f(v_1, v_2, \dots, v_3)$. Here: m_i – drivers of the marketing system; v_i – value drivers.

To sum up the analysis of the main concepts and models for marketing/financial management interaction several conclusions can be drawn:

The intangible assets created by marketing conjoin the marketing activity with the creation of company's value, because assets are the economic resources from the usage of which the company gets profit and value. So, the marketing expenditure will increase the value only if it creates an asset that will generate a positive value of the present cash flows. It is possible to distinguish four main

types of the intangible assets created by marketing: marketing knowledge, brand, relationships with customers and strategic relationships.

The fundamentals of marketing/financial management interface are based on the network principle of company's value drivers. The process of company's value creation is projected, analyzed and controlled with financial, marketing and value drivers. Though various modular company's value models are used, one of the mainly used and suggested implicit evaluation indicators for the strategic marketing decisions and the impact of created intangible assets to the company's value is cash flows and their characteristics: velocity, size, time, volatility and vulnerability. Only the predicting and analyzing of cash flows and their characteristics would help answer the question how much have marketing investments added to the company's competitive advantage in the market and how has this advantage influenced the earnings. The usage of cash flows could expand the evaluation of alternative marketing strategies; emphasize the flaws characteristic to each alternative, and to explore each alternative's sensitivity to the changes of cash flows.

Assumptions for the development of the conceptual model of marketing and financial management interface

Both in theory and practice a new attitude towards the importance of the interface of company's marketing/financial management systems is currently developing which raises new demand for the research on this interface. The developmental research on the attitude towards the possibilities of integrating marketing and financial management decisions into the context of company's strategy development and the analysis of the most recent theoretical concepts and models investigating this interface has highlighted the main assumptions that have to be followed while development a model for the marketing decisions' integration into the company's financial management in a contemporary changing environment, i.e.:

1. A value-based marketing is a management process which seeks to maximize the company's value by forming and implementing strategies creating sustaining competitive advantage and reliable interrelations with customers.

2. Company's financial management as an integral part of the management function is described as a process of making financial decisions which is related with the distribution of the company's limited resources according to the decisions of various company's areas (including marketing) in order to maximize the company's value.

3. In the context of the interaction between the company's marketing and financial management systems the creation of company's value is a synergetic process, and the company's value is a function of marketing, financial management and value creation drivers: $company's\ value = f(\text{marketing drivers, finance management drivers, value drivers}) \quad \square_{max}$.

According to these assumptions the goal of any business is to determine favourable market circumstances and to use once resources so that the value would be created for both: customer and the shareholder, i.e. to gain a sustaining competitive advantage in the market and to create an additional value for the company. Marketing can determine these favourable circumstances, and the financial management, but only in accordance with the marketing decisions, can assure an effective usage of the resources. Consequently, strategic marketing choices should be evaluated not only by the achievements they generate while determining their impact to the creation of sustaining competitive advantage and company's value, but also by tracing their influence to the financial strategies, because in some cases specific restrictions related to the issue of financial resource distribution may apply. So, the process of decision making is an interactive process. The main problem is that strategic marketing decisions which would create a requested additional company's value and at the same time would optimize the achievements of marketing and financial management have to be selected. Though in the theoretical level this problem seems to be simple it is quite complicated to deal with in the practical level since it requires a comprehensive research on empirical interrelations.

A conceptual model of the marketing and financial management interface

In the model of marketing decisions' integration into the company's financial management, the principal structure of which is provided in the picture 1, the interface of marketing/financial management related to the company's value creation is formalized by combining the concepts of value-based marketing, financial management system and value drivers; i.e. the interface of marketing/financial management is formalized by exploring the interrelations between the marketing system, financial management system and value drivers. Summarizing the theoretical

conceptualization results of this interaction: $\exists x \in K(x)$ (i.e. the goals of gaining sustaining competitive advantage in the market, suggesting unique value for the customer, and company's value creation do not contradict each other but complement each other; because the customer's value (aspects of marketing) and the shareholder's value (aspects of financial management) each separately are necessary but not sufficient conditions for acquiring sustaining competitive advantage and company's value maximization) and $(K \cap A) \sim \forall x(x \in K \cdot x \in A)$ (i.e. from the value management point of view the class of new strategic marketing decisions' seeking to create the sustaining competitive advantage (customer's value) and to increase the company's value (shareholder's benefit) becomes important) and relying on the assumptions which claim that:

Company's value = $f(\text{marketing drivers, financial management drivers, value drivers}) \rightarrow \max$ or $A = \langle M, F, V \rangle \rightarrow m \quad \varepsilon$ when $M=f(p, m_1, m_2, \dots, m_n)$; $F=f(f_1, f_2, \dots, f_n)$; $V=f(v_1, v_2, \dots, v_n)$ and by the implication threshold law $(M \rightarrow F) \rightarrow (F \rightarrow V) \rightarrow (M \rightarrow V)$ (i.e., if marketing decisions/drivers influence the financial management decisions/drivers and the latter influence company and its drivers, then marketing decisions/drivers also influence company's value and its drivers) the interface of marketing/financial management systems can be formalized with the following equation system:

$$\left. \begin{aligned} A_i &= f(M_i, F_i, V_i, W_1); \\ M_i &= f(A_i, F_i, V_i, W_2); \\ F_i &= f(M_i, A_i, V_i, W_3); \\ V_i &= f(M_i, F_i, A_i, W_4); \end{aligned} \right\}$$

here: W_1, W_2, W_3, W_4 are the vectors of the supplementary determinants of four main variables.

The main idea of this model is that evaluation of the decisions has to be based with an optimal combination of marketing, financial management systems and value drivers at the same time assessing their possible effect on each other and company's value.

One of the greatest advantages of the value analysis is that it allows the executives to determine which activities in their business should be developed more actively. Therefore, in order to select and assess strategic marketing alternatives, first of all the most important drivers to this alternative such as of marketing, financial management systems and company's value should be selected and evaluated as well as the impact of their reciprocal synergy to the company's value. Marketing position in the model is expressed through the marketing system drivers: marketing knowledge, brand equity, relationships with customers, strategic relations, marketing investments; financial position – through the drivers of finance system

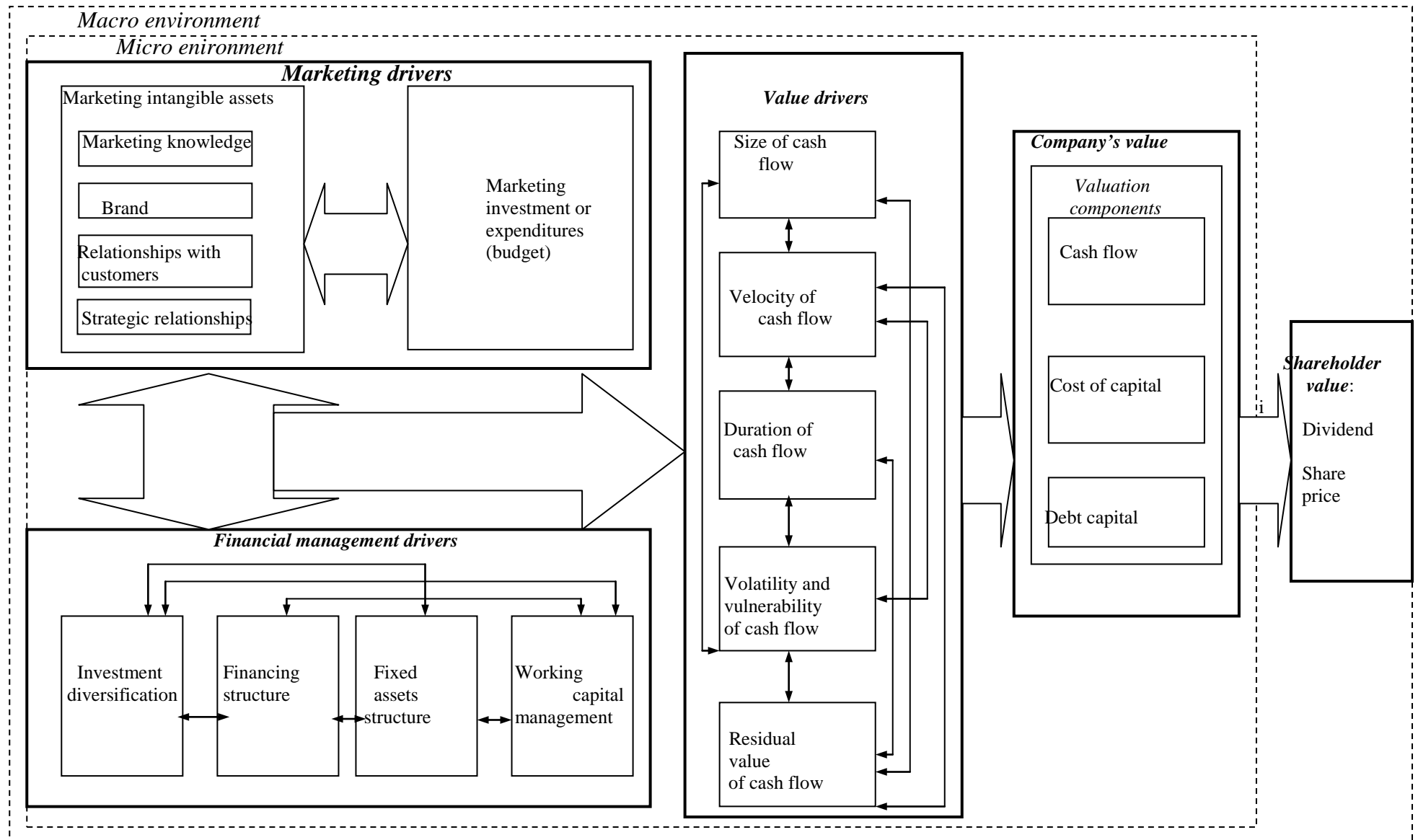


Figure 1 Conceptual model of marketing and finance management interface

management, which evaluate the investment portfolio, financing structure, structure of fixed assets, and effectiveness of the current assets management. Value drivers (or success criteria) are described as the size of cash flows, the velocity of cash flows, the duration of cash flows, the volatility and vulnerability of cash flows. The value of residual cash flows which is more necessary for the aspect of calculation when models and methods of the company's value assessment are being applied. It is important to note that financial and value drivers are only relatively discerned, because all of them could be assigned to the group of financial drivers. Company's value in a functional and business unit levels is expressed with an adequate model of company's value assessment.

Main drivers are provided in the conceptual model of the marketing solutions' implementation in the company's financial management system, however while evaluating the contribution of separate strategic marketing solutions to the company's value creation process, firstly selected are such marketing system and financial management system drivers which influence competitive advantage and fixed cash flows. The main drivers should have three basic characteristics. First of all this should be such current asset or faculty that would have a long-term influence to the competitive advantage and company's value. Second, they should be measurable and informative, and third, they should be manageable.

In addition, proper selection and establishment of the factors requires perception and thorough investigation of the company's micro and macro environment. It is understandable that the company's value as well as its factors depend not only on the activity of the company's internal activities and marketing external activity solutions with the intangible assets that they create, but also in the external drivers. External drivers may arise, for example, during the change of company's status in the competitive struggle or industry, or due to the macro environment's technological, political, economic, legal, government regulation or social changes. The change of macro environment is often the reason for the changes of the initial company's market value or cash flows. In this case important are such drivers as the cyclicity of the global and individual country's market, stock market efficiency level, change of the interest rate, fluctuations of exchange rate, tax changes, political, legal, social changes, ecological events, natural disasters, etc. Changes of the macro environment can directly change the company's market value, cash flows, sales and cost structure, or they can influence the company indirectly by changing the company's competitive or industrial conditions. The dynamics of every competitive area or industry inevitably influences the value of any company or market as well as the fluctuations of income and expenditure flows.

So, in principle it is essential to select and integrate the main drivers of marketing system which create exceptional advantage: drivers of the financial management system which reflect optimal distribution of the resources and the ability to quickly react to the new favorable opportunities in the market, and the value drivers which cause the creation of company's value.

Conclusion

The main research on the interface of marketing and financial management has shown that namely the intangible assets' created by marketing activity impact to the cash flows is the main connecting link between the marketing solutions and company's value creation, because:

- Evaluation of the company's gained wealth is related to the effective usage of the assets in pursuit of this wealth. Therefore, intangible assets can associate marketing activity with the creation of the company's value. It is possible to distinguish four main types of the intangible assets created by marketing: marketing knowledge, brand equity, relationships with customers and strategic relations. Marketing investments will augment the value only when they will create an asset which will generate pure positive present value of the future cash flows.

- One of the main and usually suggested implicit assessment indicators are the cash flows and their characteristics: velocity, size, time, volatility and vulnerability. While predicting and studying cash flows and their characteristics it is possible to answer the question of how much have marketing investments contributed to the company's competitive advantage in the market and how this advantage has influenced the earnings. The usage of cash flows expands the assessment of strategic marketing alternatives at the same time enabling the highlighting of the flaws inherent to every alternative and investigating each alternative's sensitivity to the change of cash flows.

The core idea of the created conceptual model for the marketing decisions' integration into the company's financial management is that the evaluation of decisions has to be based on the optimal combination of marketing, finance management systems and value drivers alongside evaluating their possible effect on each other and the company's value. There are several drivers of the marketing

system included into this conceptual marketing model (marketing knowledge, brand equity, relationships with customers, strategic relations, marketing investments), drivers of financial management system (which evaluate the investment portfolio, the financing structure, structure of fixed assets, effectiveness of the current assets management), value drivers (it's the amount of cash flows, the velocity of cash flows, the duration of cash flows, the volatility and vulnerability of cash flows and the value of residual cash flows), company's value and its constituents (the cash flows, cost of capital, debt capital) and the shareholder value (dividends and shares at market price). This model provides an opportunity to analyze the nature of interrelations between these drivers and to simulate various situations of marketing decisions. With the usage of this model the most influential to the specific company drivers can be determined in relation to the varying micro and macro environment. Company's value in the functional and business unit levels, analyzed in relation to the characteristics of cash flows, in a general company's level is expressed through a model of discounted cash flows.

Conceptual model expands the limits of marketing and financial management theories by integrating them into the context of company's value and shareholder's value creation and by formalizing the interrelations of marketing, financial management and company's value drivers. This model could be applied in the practice of management, because: (1) it expresses the effect of marketing decisions through cash flows and their characteristics which are understandable to the managers of all company's functional areas; (2) it emphasizes the fact that marketing expenditure are investments; and (3) it can be used while building and analyzing company's strategic marketing solutions in relation to the company's value creation.

All in all, it is stated that the prepared conceptual model of the integration of marketing solutions evaluation system into the company's financial management newly enables the improvement of marketing decision making and implementing process in pursue of company's value maximization. This conceptual model adds to the marketing theory, provides a more explicit explanation of the interrelations between marketing activity achievements and company's value achievements. In addition, on the grounds of this model an opportunity is provided to relate the aspects of marketing, financial management and accounting and to prepare students for a more efficient work in the inter-functional company's environment. Finally, by acknowledging the assets created by marketing, company's value drivers and their interrelations, this conceptual model could cause a more profound perception of marketing, financial managers, marketing content and their role in the organization.

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RATIONAL REASONING OR ADAPTIVE BEHAVIOR EVIDENCE FROM LABORATORY EXPERIMENT

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Abstract:

Many studies deal with experimental investigation of rational behaviour, which might deviate from initial concepts under particular conditions, where subjects follow rather adaptive behaviour. The aim of this study is to verify whether adaptive behaviour might be prevalent in environment of nominal values characterized by uncertainty. Our hypothesis is verified with help of the experiment based on n-player pricing game with monopolistic competition and strategic complementarity inspired by experimental design of Fehr and Tyran, (2001), where players have to cope with environment of real or nominal values. Results confirm our initial assumption that in case of nominal treatment, subjects tend to behave rather in adaptive way, since the size of expectation correction is close to simulated case of adaptive player together with substantial deviation from equilibrium. On the other hand, subjects in the real treatment behave in less adaptive and even more rational way, where the size of expectation correction is far away from the case of adaptive player and deviation from equilibrium substantially smaller. Prevalence of adaptive players under the nominal treatment has also implications in terms of slower convergence to equilibrium at aggregate level, as opposed to the real treatment where more rational players are present. Furthermore, this is in line with our illustrative simulations carried out at economy's level.

Key Words: Adaptive player, rational player, experiment, expectations, convergence

Introduction

Many studies deal with analysis of rational and adaptive behavior on experimental basis under particular conditions, for instance Williams (1987), Marimon, Sunder (1988), Hey (1994), Van Huyck (1997) with recent resurrection in studies of Bornstein, (2004), Nagel, Grosskopf (2007), Terracol (2009) or Fehr and Tyran (2008). It was shown that subjects do not necessarily behave in line with game theoretic assumptions based on rationality, but may deviate as opposed to initial concepts and switch rather to adaptive behavior as emphasized by Nagel, Grosskopf (2007). This raises question under what conditions might individuals behave in adaptive or rational way. The main aim of this study is to evaluate behavior of players under two different environments and detect whether rational or adaptive behavior prevails in case of each treatment. Hypothesis will be examined with help of the experiment based on n-player pricing game with monopolistic competition and strategic complementarity inspired by experimental design of Fehr and Tyran, (2001), where players have to cope with environment of real or nominal values. We expect that in nominal treatment, subjects will tend to adaptive rather than rational behaviour due to the factor of uncertainty and also due to rational player's conjectures about other players playing rather in adaptive way. In contrast, the real treatment should exhibit prevalently rational behaviour, since under the real frame subjects have no reason to behave adaptively and no reason to suppose that others will behave adaptively, since cognitive barrier related to nominal values is absent.

First section outlines initial hypothesis followed by description of basic experimental design. The second section provides our simulations related to individual adaptive or rational behavior together with simulations at aggregate level, which provide support for results gained on the basis of experiment. The last section reveals experimental results which are in line with our initial expectations.

Hypothesis and Experimental Design

We assume that if subjects face different environment related to their pricing strategy, they may exhibit different behavior. Under conditions of uncertainty, which require solution of cognitive task, we assume individuals to apply rather adaptive behavior, which is simply the best option. In other words, subjects under uncertainty consider rationality too costly, thereby they prefer to switch to adaptive behavior, which enables to collect at least average rewards with some certainty. This means that although only small number of adaptive individuals was present in environment of certainty, the share of adaptive individuals will significantly increase under uncertain environment. It is assumed that subjects, which would be rational under standard conditions, assess the situation in uncertain environment as untenable and switch to less costly adaptive behavior as emphasized by Smith (2002, 2003). Moreover, they may doubt if others stay rational in this uncertain environment, which is another reason for the change in their behavior.

In order to verify whether subjects tend to adaptive rather than rational behavior under uncertainty, hypothesis will be examined with help of the experiment based on n-player pricing game with monopolistic competition and strategic complementarity, (Fehr and Tyran, 2001). Individuals are setting prices, where returns are affected by their selling price and price level, determined by prices set by other firms in experimental economy. Subjects aim to maximize profits, defined as a function of their individual price and the average price level. Subjects are expected to select profit-maximizing price, which should be consistent with the total general equilibrium of the economy, if other subjects choose the correct price as well. The game has 40 rounds plus one trial period, with a group size of $n=4$. 80 subjects participated in the experiment, which was conducted in the Laboratory of Experimental Economics, University of Economics, Prague. Experiment is divided into a pre-shock and a post-shock phase. Fully anticipated negative monetary shock is implemented during the game, which is common knowledge to participants.

In order to determine whether adaptive type of players are present in uncertain environment, treatment groups are endowed by different pay-off functions, which provide them with information about their pricing strategy. Experimental treatment is represented by subjects, which receive pay-off information in nominal terms, whereas control treatment by subjects which receive pay-off information in real terms. In order for subject in the nominal environment to decide correctly about the price of his product, he needs to re-count nominal pay-off into the real pay-off. The nominal pay off is given by $P_{-i} \cdot \pi_i$, therefore in order to compute real payoff, individuals have to divide their nominal payoffs $P_{-i} \cdot \pi_i$ by P_{-i} .

The real pay-off of subject i is given by:

$$\pi_i = \pi_i (P_i, P_{-i}, M) \quad i=1, \dots, n$$

where P_i stands for nominal price, P_{-i} is the average price of the other $n-1$ group members, and M is nominal shock variable. Subjects are informed about payoffs of other subjects in the group, since x and y types players are present in both treatments, (For more detailed specification of nominal and real payoffs see Fehr, Tyran (2000)).

Since experimental group of nominal treatment requires to make distinction between nominal and real values, its environment represents higher level of uncertainty compared to the real control treatment. This will enable to examine whether phenomenon of adaptive behaviour prevails in uncertain nominal environment, after fully anticipated negative monetary shock is implemented during the game.

In experimental nominal treatment we expect behaviour, where majority players are presumed to be closer to the situation of adaptive player. Firstly, nominal frame plays the role, where subjects after the shock find themselves in uncertain situation, unable to familiarize and rather switch to adaptive behaviour in order to minimize costs. But also strategic complementarity (Haltiwanger, Waldmann, 1989) contributes to the fact that even rational players switch to adaptive behaviour, since it is optimal for them. This is caused by the fact that they believe that others will not behave rationally under nominal frame as well and thus may maximize rewards better by joining suboptimal adaptive path of behaviour. This will be reflected in character of coordination, where the size of expectation correction will be close to zero after the negative shock and distance from the equilibrium after the shock will be rather substantial. Additionally, lower speed of the adjustment to equilibrium is expected at aggregate level, since coordination effort required in order to adjust adequately is slowed down by prevalence of backward-looking individuals.

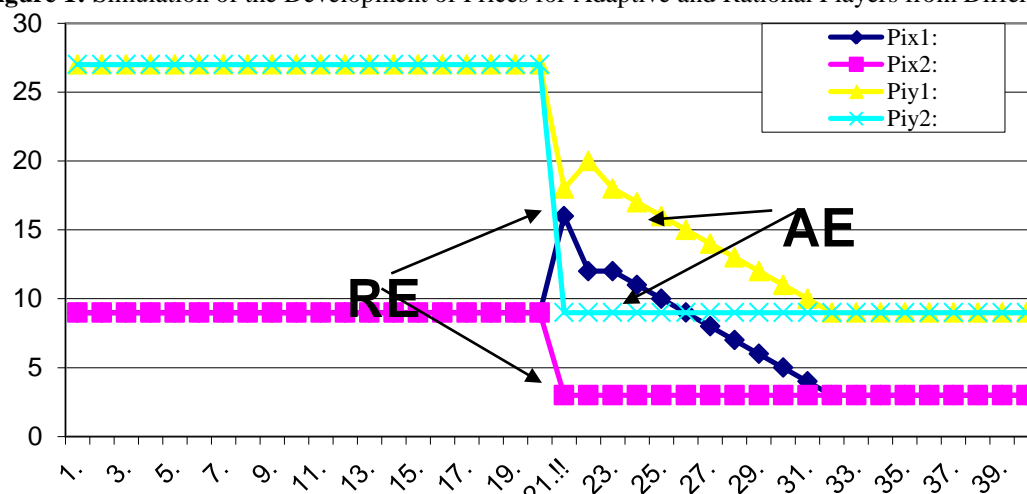
In the real treatment, which serves as a control group, we assume that more players tend to the situation of rational player, since real values are directly available for subjects without the need to distinguish between nominal and real values, which significantly reduce the level of uncertainty. Not only under the real frame more intensive expectation correction takes place, but also lower distance from the equilibrium after the shock is present under the real frame. We also predict that subjects on aggregate level will converge more quickly to economy’s equilibrium, since coordination effort is higher also due to the prevalence of rational subjects, which do not have any reason to consider behaviour of other subjects to be adaptive under the real frame.

Simulations of Adaptive and Rational Behavior

Basic simulations are addressed before discussion related to the main results of experiment. These simulations aim to introduce examples of representative behaviour of particular strategies (adaptive versus rational), which players follow in ideal cases with respect to artificial economy examined. As a result, it may provide a good benchmark in comparison with the real data gathered on experimental basis. In other words, we may evaluate easily, how closely the characteristic of players in our experimental economy is to the simulated case and thereby determine type of rational or adaptive player prevailed in particular treatment. Additionally, simulations may provide information regarding the speed of convergence in the economy, affected by the type of players prevailed. This may be further compared to the actual results gained.

We have simulated the situation of experimental subjects from different games, which behave half in adaptive and half in rational way, (See Figure 1 below). It makes also distinction according to the type of player (x or y). Monetary shock is implemented in period 21, which is a common knowledge. The simulation shows that prices differ significantly in period of the shock, with regards to whether the player is adaptive or rational one. Player of type x_1 , who behaves in adaptive way, changes the price after the shock from $P_i^* = 9$ to $P_i^* = 16$. In contrast, player x_2 with rational expectations changes the price after the shock from $P_i^* = 9$ to $P_i^* = 3$. Player y_1 with adaptive expectations changes price from $P_i^* = 27$ to $P_i^* = 18$ after the shock. Lastly, player y_2 with rational expectations changes price from $P_i^* = 27$ to $P_i^* = 9$. The adjustment to the equilibrium price is significantly slower for adaptive players after the shock and they converge only to equilibrium in the period 32. In contrast, rational players x_2 and y_1 head smoothly towards equilibrium immediately after the shock in period 21, since prices selected after the shock reflect equilibrium prices. In addition, behaviour of player x_1 after the shock might seem to be non-standard, since the price increased. We would expect movement in direction of lower prices, which is exactly the behaviour of player y_1 in the first period after the shock. However, the setting of pay-off table of player x implies that he should increase the price after the shock if he behaves in adaptive way with respect to the size of the average price in the economy given by experimental design above.

Figure 1: Simulation of the Development of Prices for Adaptive and Rational Players from Different Games.



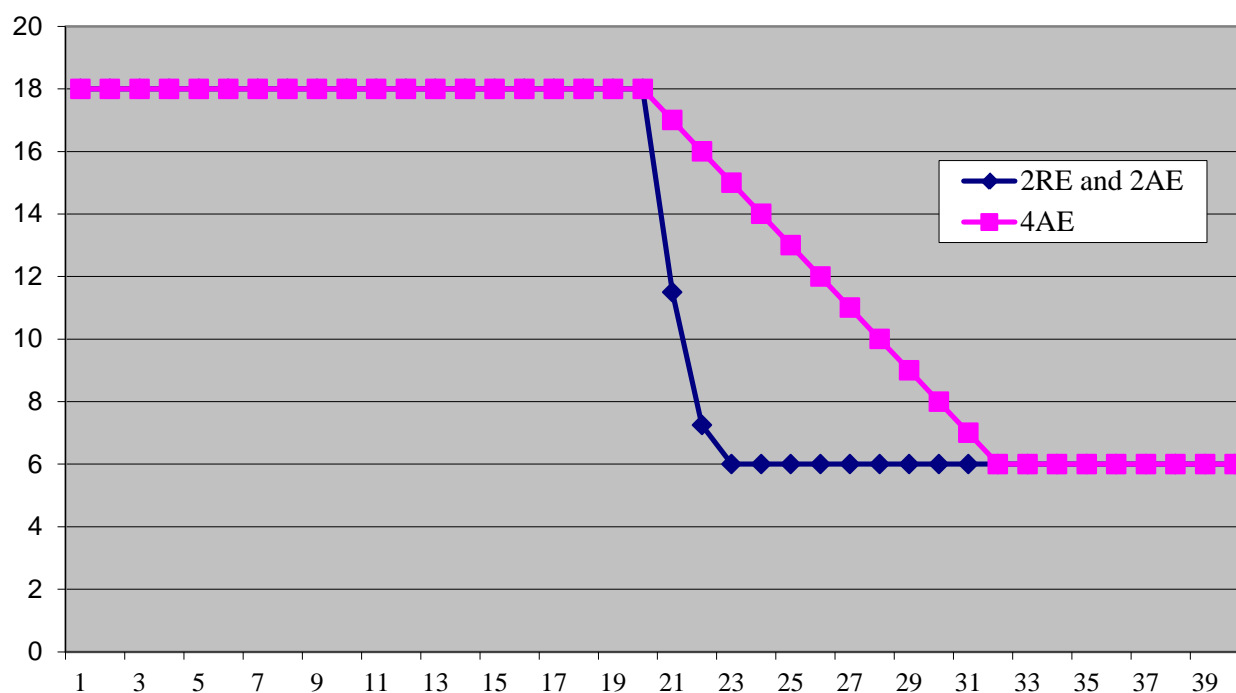
Further, we have simulated the size of expectation correction and deviation from the equilibrium directly after the shock depending on whether the player is rational or adaptive one.

Expectations of adaptive player were computed as the average price of the other $n-1$ players in the pre-shock period, where prices of these other $n-1$ players are individual pre-shock equilibrium prices given by experimental design, since behaviour of naive adaptive player is delayed and based on prices of the previous pre-shock period. When getting values for type of x and type of y of adaptive player (the size of expectation correction is 0 for both types), the average size of expectation correction equals 0. Similarly, based on experimental design, we computed for the average deviation from equilibrium directly after the shock, which is 11 for adaptive player, (deviation for player x is 13, deviation for player y is 9 consecutively).

Expectations of rational player were computed as the average price of other $n-1$ players in the post-shock period, where prices of other three players are their individual post-shock equilibrium prices, since he is no longer interested in the past price development. After getting values for type of x and type of y of rational player (the size of expectation correction is 14 and 10 consecutively), the size of expectation correction yields 12, which suggests that rational player adjusts substantially his expectations with immediate movement towards equilibrium after the shock. Similarly we computed for deviation of rational player from equilibrium directly after the shock, which is 0, (for player x deviation equals 0, for player y also 0).

Till now, we have simulated individual behaviour of particular players, which may emerge in our economy. This individual behaviour may have serious implications for convergence at aggregate level, depending on type of the player prevailed. Therefore, we have also simulated two economies, where the first one is composed of two rational players (RE x and RE y) and two adaptive players (AE x and AE y) and the second one is purely adaptive economy (4AE), (See Figure 2 below). The adjustment to the equilibrium price is for the first economy significantly faster than for purely adaptive economy. Moreover, the inclusion of only two rational players is sufficient in order to ensure smooth and relatively fast adjustment to economy's equilibrium. In contrast purely adaptive economy, which relies solely on backward-looking behaviour, is characterized by slow convergence to new equilibrium after the shock and converges in period 32. In contrast, the first economy converges in period 23, which is relatively fast adjustment if the share of rational and adaptive players is comparable. This suggests that smooth convergence might be achieved even in case of the economy, which consists only partly of rational players.

Figure 2: Development of the Average Price in two economies: 2 RE, 2AE and pure AE



Results of Experiment

Simulations above suggest that adaptive player in ideal case corrects expectations in no way in the first post-shock period and deviates by 11 directly after the shock, with consequent pricing path, which reflects only slow backward-looking adjustment to new equilibrium in following post-shock periods. On the other hand ideal rational player corrects expectations significantly by 12, with zero deviation from equilibrium directly after the shock, with relatively fast convergence towards equilibrium even in the first post-shock period. Based on simulations, this is reflected also on aggregate treatment's level as illustrated above. Following section will reveal whether adaptive behaviour will be present under the nominal treatment with less frequent expectations correction and slow adjustment to equilibrium, compared to the control group of the real treatment, where subjects are assumed to be rather rational with substantial expectation correction and relatively fast adjustment to equilibrium.

Following test enables to detect not only whether subjects follow rather adaptive behaviour in uncertain environment of the nominal treatment compared to the real one, but also whether they get acquainted with experimental instructions and whether they reflected this consistently into consequent behaviour. In other words, the aim is to evaluate how far subjects corrected their expectations about the price in the first post-shock period with consequent pricing strategy after the shock. This will be evaluated with help of the following regression:

$$(P_i - P^*) = \alpha + \beta * (\bar{P}_{-i} - \bar{P}_{-i}^e) + \varepsilon \quad (1)$$

Where $(\bar{P}_{-i} - \bar{P}_{-i}^e)$ is deviation of player's expectations for the post-shock period to the pre-shock actual price level (i.e. the size of his expectations correction) and $(P_i - P^*)$ is distance of subject's individual price from equilibrium in the first post-shock period. The coefficient β measures, how the size of expectations correction is reflected into consequent distance of the subject with his individual price from equilibrium. If the coefficient $\beta=0$, then the size of expectation correction has no effect on distance of the subject from equilibrium, which reflects non-consistency of decisions. If the coefficient $\beta < 0$, then two situations may arise where the player is consistent with his decision-making. Either consistent adaptive player is the case, where the closer the expectations to the past pre-shock price, the higher the deviation of individual price from the optimum in the post-shock phase. Or consistent rational player is the case, where the higher the expectations correction, the lower is the deviation of individual price from the optimum in the post-shock phase.

Based on simulations applied on the player of type x, the case of consistent adaptive player looks as follows: the past pre-shock average price was $\bar{P}_{-i} = 9$, where zero expectation correction takes place and thus expectations are in line or very close the past pre-shock average price, i.e. $\bar{P}_{-i} = 9 = \bar{P}_{-i}^e$. The equilibrium price, which reflects perfect adjustment for type of player x is however $P^* = 3$. Difference between individual price and optimum is higher, the most inertial being $(P_i - P^*) = 6$, which is our simulated case. Similarly we would apply our considerations on player of type y.

Behaviour of consistent rational is described as follows: high expectation correction takes place and therefore expectations are much further from the past pre-shock average price, i.e. $\bar{P}_{-i} > \bar{P}_{-i}^e$. After the shock individual price of player of type x is in line with equilibrium post-shock price, i.e. $\bar{P}_{-i} = 3 = P^*$. Difference between individual price and optimum is very low, in ideal simulated case $(P_i - P^*) = 0$. Similarly we would apply our considerations on player of type y.

Thus, for the consistent behaviour it holds:

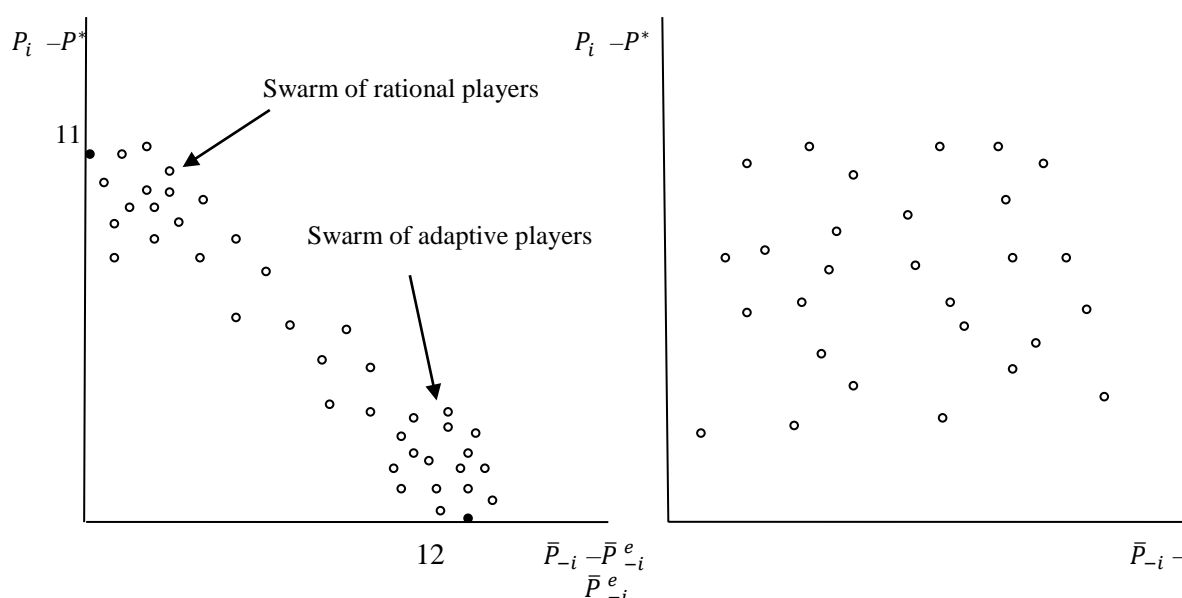
Either if $(\bar{P}_{-i} - \bar{P}_{-i}^e)$ is high, then $(P_i - P^*)$ is low, which is the case of consistent rational player.

Or if $(\bar{P}_{-i} - \bar{P}_{-i}^e)$ low, then $(P_i - P^*)$ is high, which is in line with consistent adaptive behaviour.

As a result, such consistent behaviour is associated with the coefficient $\beta < 0$.

Following Figure 3 describes theoretical case of consistent and inconsistent behaviour of subjects at aggregate level. Illustrative case shows that consistent behaviour is present at aggregate level, where either the subject might be adaptive or rational, but still the consistency is reflected in their behaviour. On the x axis ideal case of consistent rational player is present (see black small point), whose expectations are further from equilibrium, according to simulations $\bar{P}_{-i} - \bar{P}_{-i}^e = 12$ on average, but the adjustment of individual price to equilibrium is perfect, where $P_i - P^* = 0$. In contrast on y axis ideal case of consistent adaptive player is present, whose expectations are very close to the pre-shock price, where $\bar{P}_{-i} - \bar{P}_{-i}^e = 0$, but individual price is far from optimum, according to simulations where $P_i - P^* = 11$ on average. Starting at the position of ideal rational player, the lower the expectation correction is, the higher the difference between individual and optimum price becomes. There is tendency to be less rational and more adaptive, for players, who emerge in this space.

Figure 3: Consistent and Inconsistent Behaviour in the Economy



If we begin at the position of adaptive player, then the higher the expectation correction is, the lower the difference between individual and optimum price. This implies less inertial behaviour and tendency towards rational behaviour for players who emerge further from ideal case of adaptive player. Nevertheless, whether present closer to ideal case of adaptive or rational player, distribution of players depicted in Figure still respects consistency, where $\beta < 0$. Right graph of Figure 3 depicts the situation, where rather inconsistency is present, since no relationship is present between the expectation correction and distance from equilibrium. Moreover, we may not distinguish between the swarm of adaptive and rational players so clearly.

Presumptions Regarding Results

In line with our initial hypothesis, we expect in case of uncertain nominal treatment (which is our experimental group) more players to be closer to the ideal situation of adaptive player. Thus, under the nominal frame weak coordination effort related to uncertainty will lead to the fact that subjects will be closer to left upward part of y axis, with expectation correction approaching to zero and higher distance from equilibrium, followed by implication at aggregate level. On the other hand, in the real treatment we expect more players present closer to the ideal situation of rational player, with intensive expectation correction and negligible distance from equilibrium. This should lead to the fact that majority of players will be close to the right downward part of x axis, whereas not many adaptive players will be present close to the y axis. However, common expected result for both treatments is that consistency should be reflected in incidence of players in line with $\beta < 0$.

Results for the nominal treatment (NH Mgr)

The model is significant at the 5% level, where the coefficient β is negative, which confirms that even in the nominal treatment, subjects proved to behave in consistent way (See Table 1 below). Based on results if the expected price level declines, the player will reduce his price.

Table 1: Nominal treatment, (Experimental Group)

	Coefficient	t-value	n	R2
<i>constant</i>	12.4859***	18.2	44	62.46%
$(\bar{P}_{-i} - \bar{P}_{-i}^e)$	-0.833861***	-8.36		

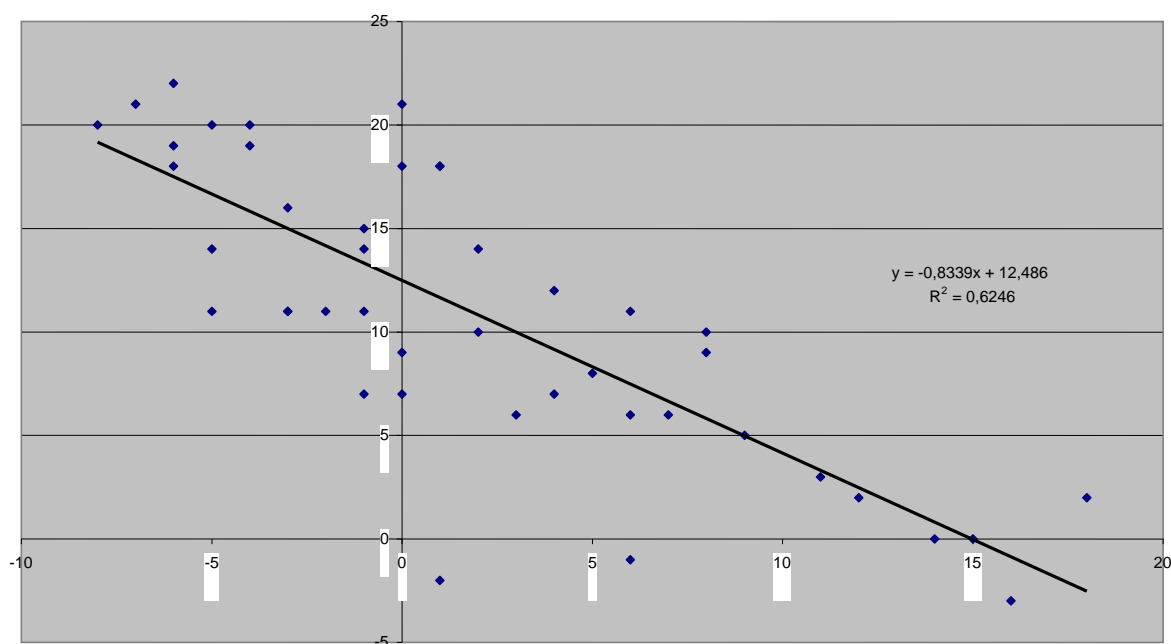
Notes: $(\widehat{P}_i - P^*) = 12.48 - 0.83 * (\bar{P}_{-i} - \bar{P}_{-i}^e)$

*** Significance at the 1-percent level

Additionally, if players do not correct their expectations at all, the coefficient β equals 12.48. In other words deviation from equilibrium is 12.48 is very close to the simulated case of adaptive player, for which the deviation from equilibrium in case of zero expectation correction is 11, (See Figure 4 below).

Introduction of the nominal frame in this economy however proved to affect behaviour of players, where more of them corrected their expectations inappropriately compared to the real treatment and thus ended even at the upward left part of the graph, (i.e. their expectations about future post-shock development were even higher than the pre-shock average price). Nevertheless, the difference as opposed to the real treatment may be confirmed, where players do not correct their expectations in so intensive way like in the real treatment and are closer to behaviour of adaptive player. The same holds for distance from equilibrium as mentioned above. Despite that, still it is visible that trajectory reflects consistent direction, where points respect mostly negative slope of the curve, i.e. $\beta < 0$.

Figure 4: Difference from Optimum on Expectations Correction, the Nominal Treatment



Possible explanation for frequent occurrence of adaptive players in nominal environment lies not only in uncertainty, which induces players to switch to adaptive behaviour, but also in strategic complementarity built in experimental design, where rational players have no reason to doubt that

other players will behave in adaptive way and thus adjust their behaviour accordingly in order to maximize rewards. Therefore the share of adaptive players is substantial. This has additional implications, since due to the majority of adaptive players prevailed under nominal treatment convergence to aggregate equilibrium is significantly decelerated.

Results for the Real treatment (RH Mgr)

Based on results in Table 2, the model is significant at the 5% level, where the coefficient β is negative, which implies individuals were consistent, because if expectation correction is present, price adjustment takes place. Moreover, Figure 5 below shows that players are found more frequently in sector closer to the case of rational player if compared with the economy of nominal treatment and difference from optimum is not so striking either.

Table 2: Real Treatment, (Control Group)

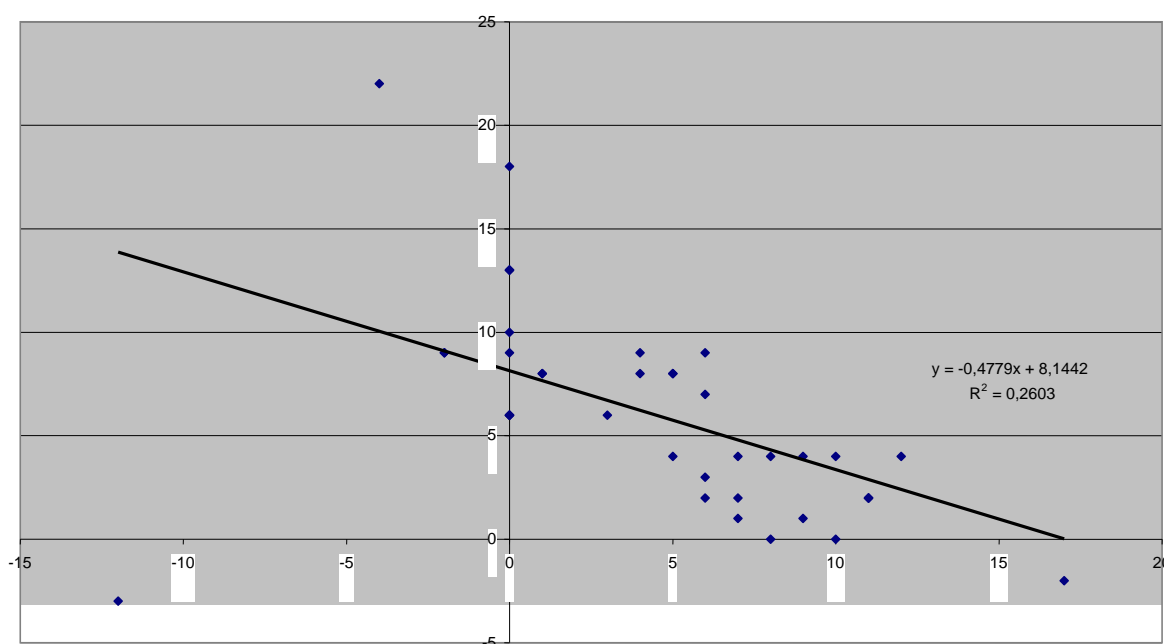
	Coefficient	t-value	n	R2
<i>constant</i>	8.14424***	9.13	40	26%
$(\bar{P}_{-i} - \bar{P}_{-i}^e)$	-0.477926***	-3.66		

Notes: $(\widehat{P}_i - P^*) = 8.14 - 0.4779 * (\bar{P}_{-i} - \bar{P}_{-i}^e)$

*** Significance at the 1-percent level

This is in accordance with our previous presumptions. In addition, it suggests that players in the real treatment corrected their expectations more frequently. If expectation correction is approaching to zero, which is ideal case of adaptive player, then deviation from optimum is 8.14, (See Figure 5). However, only few players follow very closely ideal adaptive behaviour. In this case the channel of strategic complementarity under the real frame is substantially weaker, since subjects do not have any reason to believe that other subjects will behave in adaptive way, since no barrier related to converting of nominal values into the real ones is present. Thus, prevalence of rather weaker adaptive or even rational behaviour in this treatment implies that convergence to equilibrium is significantly faster, as was already demonstrated with help of ideal simulations.

Figure 5: Difference from Optimum on Expectations Correction, the Real Treatment



Conclusion

This article aimed to evaluate whether subjects tend to adaptive rather than rational behavior under uncertain environment of nominal treatment, where subjects have to overcome barrier of nominal pay-offs. Our initial hypothesis was confirmed via experiment based on n-player pricing game with monopolistic competition and strategic complementarity in vein of Fehr and Tyran (2001), where subjects cope with either nominal or real pay-offs. In order to provide appropriate grounds for experimental results gained, simulations were performed. Thus, results of our investigation are two-folded.

Firstly, simulations proved that individual behavior of both types of adaptive players in our experimental economy is associated with substantial backward-looking behavior, where only slow movement towards post-shock equilibrium is present. Additionally this adaptive behavior is associated with zero expectation correction and significant deviation from post-shock equilibrium at size of 11 on average. In contrast individual behavior of both types of rational players exhibits quick adjustment to equilibrium, where zero deviation in ideal case is present on average and substantial expectation correction is present after the shock at size of 12 on average. This is also reflected at aggregate level, where simulations suggest that even equal share of rational versus adaptive players in the economy is sufficient to converge smoothly to equilibrium. In contrast, simulated case of purely adaptive economy indicates slow convergence dependent on pre-shock average price of the economy.

Secondly, experimental results proved our initial hypothesis. In case of nominal treatment, subjects tend to behave rather in adaptive way, since the size of expectation correction is close to simulated case of adaptive player together with substantial deviation from equilibrium. On the other hand, subjects in the real treatment behave in less adaptive and even rational way, where the size of expectation correction is far away from the case of adaptive player and deviation from equilibrium substantially smaller, in line with previous simulations. Prevalence of adaptive players under the nominal treatment has also implications in terms of slower convergence to equilibrium at aggregate level, as opposed to the real treatment where more rational players are present. This is also in line with our previous simulations, where the nominal treatment is closer to the situation of adaptive economy, whereas the real treatment is closer to the situation of the economy mixed of rational versus adaptive players. Additionally it was proved that subjects in both treatments behaved consistently.

Results indicate that when subjects have to cope with uncertain nominal environment, they tend to switch to rule-guided (backward-looking) behavior of adaptive type, which is the best option in terms of costs minimization and as well in terms of strategic complementarity, where it is optimal to follow behavior of other players, although they behave in suboptimal way, since rewards may be maximized. In other words, it appears that rationality under uncertain environment of nominal values is more expensive, which has been revealed in comparison of the nominal versus real treatment and character of players prevailed. This is certainly reflected in the size of rewards gained by rational versus adaptive players, whose evaluation might be suggestion for future research.

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THE CHALLENGES OF THE APPLICATION OF "MARKWARE" NOW IN ALGERIA

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Abstract:

The economy of the entire nation is continually influenced by the environment in general and particularly the political economic, marketing, management must serve at all times to enable the achievement of development goals.

Again, it is imperative to force as an economic update to managerial vision for scoring the maximum possible developments and, as compared to wills change (given the globalization of markets and the revolution information in all its shapes), as compared to the drawbacks that firms are suffering from every day because of the competition, the existence of the informal sector and increased behavior of the consumer more unpredictable.

Control competitiveness strengthened by managerial intercultural management leaves little choice for the company that aims at performance: it must ensure its ownership to its market as well as the overall supply.

The effort of "adaptability" will cost the adoption of certain indisputable principles in marketing-management domain, which commit to further skills development...

The "MarkWare" as proposed by Yves Le Golvan (marketing dictionary, 1988) implies that the company adopted eight key concepts of marketing management-all complementary, although some of them have more than one operational aspect Strategic these are the following fundamental concepts (as quoted by Yves Le Golvan): Market needs, vocation, positioning, marketing mix, differentiation, image, profitability and planning.

The Algerian company (in this case public one) as far as it is concerned, witnesses fluctuating conditions due to imposed reforms without paved the way, as to make contradictory and generating crisis and deficit. Integrate "MarkWare" in a new context with a traditional economy requires that the undertaking concerned is seriously considering issues while undertaking a review of its management vision then a new approach involving as wholly adapted marketing.

With regard to some investigations that we conducted with a sample of three Algerian public companies which already express a diagnosis denounce the consequences of instability and under management, we will try in what follows to study real issues in the applying of the "MarkWare" within them.

Key Words: Management, marketing, "MarkWare" economic context, stakes

Introduction

Follow the evolution of the global economy is to adopt the principles of the new economy called "digital" or "numerical" who is experiencing the full growth in most advanced countries in the New Technologies of Information and Communication (NTIC).

This new context (global) imposes new conditions of development as the developed countries to developing ones.

The applicability of any economic system would be conditioned by many rules and principles of management, starting with the same vision of the company.

We cannot therefore achieve the expected-for-performance and competitiveness if the economy does not follow, in the sense that the modern economy is one that best fits the current practices of management.

It is high time for us emphasized that in Algeria a lack appropriate theoretical model on which we would have thought to achieve finally a real upgrade of the Algerian economy.

In order to do this, we are committed through this research to study the reconciliation of alternative managerial principles, on the one hand with the economic imperatives, with the commitment of leaders within economic entities on the other hand

Otherwise, assuming the existence of some willing for development and growth, a question will continue to torment us as follows: "dualism backward economy and new managerial system, he is likely to exist?"

This research proposes an answer requiring exposure of marketing-management policy of a public companies sample, while studying issues that could offer their entire context and while checking the application of eight fundamental concepts of marketing-management that «MarkWare» has on them.

Issues consistent with this application could inform us about the chances guarantee the applicability of the "MarkWare" in Algeria.

Marketing, Business And The Economy

The objective is the major focus of any entity, the purpose is the long-term direction of the business of any company, in this context, it should be counted (while distinguishing them), the profession, the mission the identity and culture of the company. The goal is to obtain the general result without specifying the time horizon of quantitative data ,contrary to the objective that defines the time (via quantifying) the goals of the company and is a management tool for operational aspect .

Performance in turn includes two complementary aspects:

- Effectiveness: results in achieving the goals already set.
- Efficiency: results in minimizing the use of assets and resources in fulfilling the objectives.

The company seen as dependent on the theory of its creation, its structure, its organization, its strategy and its decision-making centers, is being regulated by environmental factors, macro and micro types

Two visions of the environment are in mind:

- The traditional view: the company is more concerned with competition than its market; identify environmental concern, however is lesser;

- The new vision: The company received favorably the shift and handles events in a creative way, which implies a perfect knowledge of the environment. The care of creating customer value and satisfaction the latter desires at most is consequently obviously expressed.

Marketing being what contributes most to the achievement of organizational objectives by creating, revealing and promoting the value to the public, companies and their clients (Lendrevie & Lindon, 2003); in a market economy, the objective is to maximize the yield of capital invested for shareholders, which implies the implementation of various short-term goals hence, the idea of performance and survival of the company.

In marketing concept, business management is based on performance, not on sales volume; it is the spirit of the long-term profitability which cannot be achieved without bringing more value to customers. A concept is thus born (P. Drucker taken by Colombia Harward, 1996): the strategy provided value, requiring us to stick to the customer, competition and profit.

Marketing is a great creative function value (thanks to its various functions that are complementary in the whole) to the client (short-term) and long-term for the company (which returns to profitability in its wide sense).

Economic development is the result of the effectiveness of macro marketing, marketing is then a real key to growth. However, it is still the most delayed and poorly developed economic systems at the same time the party which can be improved soon.

Improved marketing makes better use of economic resources, becoming more adapted to the needs of the consumer.

The new economy called the "network economy" is based on three pillars (Gilles Gernier, 2000): information, the ability of the process (information system) and its transport (telecommunications and internet): an economy based on new technologies and especially the internet.

It is nowadays a market economy, however working differently that is based on direct communication between producers and consumers by encouraging us to move from an economy based on products and services in an economy centered on the client and expectations (G. Gernier, 2000). Note that the marketing is defined as the foundation of customer knowledge, which allows you to customize the offer intended for him, through the analysis of its behavior. Thus was born the concept of "Customer Relationship Management" CRM known as integrated system used to predict, plan, manage and monitor the activities before and after sales.

the marketing concept as far as it is concerned, (and in this case strategic) has its own contributions to economy, management as well and facing the evolution, individualization, specialization, concentration, dimensions diversification and performance.

Net economy has in turn strongly influenced marketing imposing a new economic system with all its requirements, including the largest, the adoption of information technology. Which enhances the effectiveness and efficiency through a system called intelligence. E-marketing is to be so close to the business market.

The "MarkWare" Conceptual And Its Implications On The Company

Marketing was initially considered as an important tool for management will be not the only one, except that the managerial changes sought more than other disciplines, which is due to its flexibility in view of her multi disciplinary aspect.

The company is surrounded by a variety of factors highly scalable, which pushes to develop its own "sub-systems", i.e., vision and thus its spirit, its structure and therefore its content, style, and thus its procedures, its operating system and thus information (both internal and external), the reflection system and therefore its strategy, hierarchy and thus its expertise. The company operates in a contemporary managerial context again, for the performance and survival, thanks to economic models and marketing. This is called conditions excellence in business, as proposed by McKinsey as the "7S".

As concerns Y. THE Golvan, he offers a set of eight concepts

(Some of which are a strategic, other, operational) as the "MarkWare" which is a "cocktail" of concepts like marketing and management in the same time.

Vocation is one of the first company's forces to assert its vocation, it is sometimes called mission and defines the nature of the needs met by the offer, unlike the business which focuses on the product. It therefore requires that one takes the buyer's point of view (Luc Broyer & Noel Equilbey, 2000). Note that this is the global policy which defines the aptitude, the purpose and goal of the company. Marketing policy came up the global policy, and therefore from the vocation while providing a substantial number of choices.

In fact, in modern vision "market-oriented", establish the relationship between market orientation and business performance returns to discuss question of the purpose and identity of the company and hence the mission and business (Gilles Marion & collaborators). Two

concepts arise from the vocation of a company: the willingness of leaders and the long-term plan.

Planning consist of a strategic approach to examine the relationship between the dynamics of the company's environment and its various activities. The marketer must provide criteria to identify the diversity of activities and cut the company strategic areas (DAS) for which a specific strategy can be formulated (Gilles Marion & collaborators). Thus, the marketer contributes to the overall strategy of the company (corporate strategy) and business strategies (business strategy). The brand image is linked to the perception towards oneself or others, it is considered as subjective and includes several components such as the logo, colors, graphics etc.. A good image should be fair, positive and original. It greatly affects the performance and productivity and is called "good will" or goodwill, when it is the subject of a constituent stock of its business. The image is considered a very important management tool involving the development of institutional marketing.

Another good way to identify and then to differentiate themselves from the competition are: positioning consisting of what is due to the potential customer's mind (Catherine PARIS, 2001). This concept translates into expanded notions such as advertising positioning, brand, product, company, store and even politicians. The key is to find an empty slot corresponding to the expectations of consumers and is not threatened in the immediate rivals. It is a part of both the business strategy and the implementation of the marketing mix.

Differentiation suggests that the company chooses distinctive features (often built by the brand and communication) in order to compete effectively in the market. It is singling supply by any means (i.e. differentiation from the top) against competition front by the price, or takes the form of a "down differentiation" "on the basis of a lower relative price. As one of its main axes, the performance is widely due to a question of quality and cost.

Market needs require such concept, which identifies the market and the needs of, and to satisfy the entire market given the heterogeneity of customers, while imposing segmentation. It is a purely operational concept that neither the market nor needs are considered stable factors: the instability that characterizes determines the effectiveness of strategies based on their often short term.

The marketing mix is the combination of the "4P", and can achieve efficiency without balance and consistency. In addition to its compatibility with the resources of the company, it must have a distinctive character vis-à-vis the competition in order to satisfy the market and enable the achievement of profitability.

Profitability is sometimes seen as objective, sometimes as a performance indicator. It is, however, the financial stability of any business even if it takes several forms: commercial, economic, financial, social, etc. It refers to the concepts of profitability, efficiency and productivity. It is called global when it concerns any marketing activity. It is called economic activity or when it concerns the management of the company.

From the above, we note that the "MarkWare" cannot bear fruit without interacting with the "7S" and concepts related to managerial process. It is not enough (alone) to idealize the management within the company. Several interactions occur:

The style of planning and strategy lead to profitability, marketing mix and market needs.

Information system entails differentiation, strategy, intelligence, marketing effectiveness, , managerial performance, adaptation, intelligence & business intelligence, business and experience ..

The mind leads to economic performance, culture and managerial vision.

Structure leads to marketing strategy, marketing mind, the effectiveness of decision-making and control culture.

The staff leads the mind marketing and organizational performance.

Algerian Enterprise And Its Global Context

The economic context of the Algerian company (yet traditional) has long been a highly volatile due to increased disturbance of the process of doing business in Algeria. This has resulted in serious consequences such as abundant experience, distance to market and the loss of performance.

Several changes have occurred in the economy such as globalization of markets and the information revolution, however, the company has not traditionally benefit, and, because of its host uncontrolled competition and its passivity front thereof. On the other hand, the acquisition of ICT is quite expensive to use it in fact (the long-term profitability is far from obvious in the Algerian entity, especially public one!). The fate of traditional and industrial sectors are not clear, the informal sector does not enjoy the location as an intermediary between both of them!

A considerable change marks our society: "post modernity" due to the plurality of values and style and the elimination of ideologies prevalent. Alas, in response to this development, the Algerian company has not demonstrated reactivity! Note that there is an important point for multinational companies, which otherwise would have encountered serious obstacles to activate in Algeria.

Moreover, the evolution of participation outstanding communication and information to socio-cultural is seen through many Algerian consumer loyalty to foreign media, yet participation rather negative company Algerian management policy loyalty of its audience.

The collapse of traditional values and the crisis of the link gave the idea of emigration to the Algerian youth and skills, which increasingly impoverished the socio-economic system of one of the most expensive resource that is the human resources.

The hyper choices the consumer knows besides his prejudices due to prior retention policy carefully developed and implemented by the foreign producer can only be at the expense of the local product and the national economy, moreover individualism in consumption experienced by the contemporary Algerian does not reconcile with rationality in the purchase!

Finally, the tendency to overuse harms necessarily the local economy as it does not concerned local goods and against this, there is almost no production.

This context considered quite relevant to the Algerian company forces it to confront the aggressive competition, the uncertainty of the environment, etc., And to ensure its stability and durability. It must therefore bring back to his managerial style by developing a number of skills such as anticipation, innovation, reaction, federation and communication & intelligence.

Evaluation Results Marketing-Management In The Company Of Algeria

Through this part of the research, we will have to analyze the situation of three managerial Algerian public companies, policy activity called "A", "B", "C", and, by process: a typical evaluation of marketing effectiveness by taking the evaluation scale Kotler and Dubois, marketing, management while educating first questionnaire (I), then we proceed to the evaluation of managerial efficiency by taking a qualitative study and completing one second questionnaire (II).

Questionnaires I & II are designed on the basis of methodological objectives of commercial diagnosis and of methodology proposed by Christian Michon (diagnosed Business). Evaluation forms will then be used to develop the strategic matrix to finally provide explanations to the current situation in the studied companies.

Presentation of the evaluation results of marketing effectiveness

It is a diagnostic analysis based initially on a study of the marketing function from the evaluation of its balance sheet to its brand and business internal control. In the second phase, we will endeavor to make a diagnosis from the perspectives: strategic, organizational,

methodological, and operational manager, in pursuance to method Christian Michon commercial diagnosis.

Elements of our sample are large firms belonging to different sectors namely:

- The company "A" is that of pharmaceuticals,
- The company "B" is for the energy,
- The Company "C" is that of services.

The first flaw to note in this sample is due to the vision and management philosophy and to the corporate culture. That affects management systems and evaluation, resource allocation, opening the business on the environment, the overall potential of the company and the performance in terms of marketing-management.

However, it is to be noted that the "MarkWare" is still adopted 50% for companies "A" and "B" and only 30% for Company "C", however the marketing effectiveness is assessed for all of these companies as low in view of the optical reigning :sale or production sales.

The management philosophy is more or less modern unclear materialized and this is due to the misinterpretation of the business and structure of the market, and thus its true position (we often think we are alone in the market, and yet ...), or the state of mind prevailing level of the hierarchy and structure, or marketing orientation, or the potential of the business proved too bad assessed so as to go towards a new sense of managerial vision.

We do not lose sight; however, considerable advantages enjoyed by these companies, namely, the reputation, experience and assistance of the State. These are the competitive advantages that are lacking alas

For the company "E", "MarkWare" seems to be partially (rather shyly) adopted, resulting then in a positive trend towards modern management, but remains insufficient because other key success factors lacking in their management. We emphasize this lack of spirit of creativity, research and innovation and denouncing the lack "of a marketing approach and ownership concern

For "A" and "B", however, we note that at least they are trying to adopt the approach itself but without integrating it into their managerial process: which distorts its appliance and requires the company to deviate sometimes vision, sometimes his vocation etc.

Indeed, disturbance, reforms, etc. unexplained changes block businesses orientations. The effects of instability long known by the Algerian company have views through the various contradictions that they know both their vision, philosophy and optics, as their activity, planning, action etc..

This is what explains the discrepancy between the calling and planning within the same company!

Results of the managerial performance evaluation

Throughout what follows, we will take further analysis based primarily on the evaluation, in order to deduce the key concepts of success and competitiveness derived from our research, and at two levels, namely:

- The level of managerial performance, and through the criteria of organization, management, marketing management, technology and financial health, in order to study the coherence of "MarkWare" with strategic of the company;
- Globally and in referring to data collected in the previous step against key performance factors in business.

To do this, first summarize the results of managerial efficiency (due to strategic SWOT analysis):

- In relation to the adoption of the concepts of "McKinsey 7S"
- "A" to adopt almost all but in a very partial way;
- "B" is adopted in the information system as a whole,

"C" does not adopt any;

- In relation to the adoption of MarkWare:

"A" adopts four two concepts only in a very partially way

"B" adopts five concepts which part of in partially way

"C" adopts six concepts all of them in partially way

- Compared to the results of the SWOT:

"A" records 29 forces (most of which is due to its strengths and its balance of brand and trade) out of 11 weaknesses

"B" records 30 forces (most of which is due to its strengths and its trade balance

"C" records 19 forces (most of which is due to the balance of brand and commercial, single weakness is due to diagnostic methodology) out of 21 weaknesses;

An analysis of the multiple linear regression revealed that the management philosophy influences managerial efficiency in the foreground, which amounts to deduct the purely strategic mindset and managerial vision in any entity elsewhere!

Conclusion

We found during the diagnostic analysis, in a vicious circle with the basics: the managerial process reinforced concepts as related to the organization (itself, its organization and balance), only vision of the company, and the evaluation of the performance thereof.

The "MarkWare" is not an end in itself; it is conditioned by all the factors governing the managerial process.

The mindset (coming up from culture) remains an essential element of said process, in addition to the managerial vision and its various optics.

From the perspective of better management changes already imposed in our business, a number of changes have to be considered, namely:

- Adjustments of organizational type;

- A vision of managerial style starting with a review of management procedures and standards already installed, or (for lack of), the imposition of the latter;

- An additional reflection about the process of strategic planning;

- A proficiency testing and performance assessment to plan training that is required-with-ICT;

- Adaptation to customer's individualism and even global society;

- Social inclusion to recover the Algerian consumer and / or to retain him;

- The marketing mix for successful market economy;

- Finally, the adoption of a degree of flexibility, both in his thinking, his action or his reaction.

Competitiveness managerial enhanced by development intercultural leaves no choice to the Algerian company to "get with it!"

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THE IMPACT OF TRADE SUBSIDIES ON THE ENVIRONMENT: A PROBLEM FOR THE WTO TRADING SYSTEM

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Abstract:

The principal objective of the WTO is to promote free trade among its Member Nations. Along with this main objective are also compounded values such as sustainable development, the pursuit of which goes along with free trade. It is ironical that within the WTO trading system, there are several agreements to promote free trade, but no explicit agreement supporting environment-related issues on a parallel basis has been adopted.

After analysing the practices followed by the Member States, it seems that trade interests are prevailing over the environmental issues, because the general description of the subsidies within the WTO framework does not cover trade advantages obtained by giving priority to the practice of trading at the cost of the environment values. Looking at this issue from the perspective of the WTO trading system, it seems that the outcome of prioritising trade at the cost of the environment is the same as the use of non-permissible subsidies for the promotion of trade. As an example, the effect of unregulated subsidies on the environment can be seen in the fisheries industry. Trade subsidies, without checks and balances have depleted several species of fish even to the level of their extinction.

As the basic objective of the WTO is to promote free trade, subsidies on the contrary are being used by the Member States to compete with each other in market systems allegedly following free trade. This article attempts to explore the effect of subsidies as a consequence of free trade, which in a way takes the form of non-permissible subsidies, on the environment from two perspectives. The first, is that the principle of sustainable development is being subjugated as a result of unregulated growth in trade between Developed and Developing countries. The second, is that trading between the nations, through bilateral treaties without taking into account the environmental standards followed by the country producing the goods has led to harmful effects on the environment. Example referred is such as, the dismantling of the ships. The trade advantages sought by shifting of these industries have been compared to the monetary benefits obtained and in the specific context of this article, have been related to the actionable subsidies.

Finally, this article concludes by making the suggestion that a compatible approach should be adopted so that free trade would not have negative impacts for environmental standards.

Free trade is distributing money but damaging the wealth of nature

Key Words: Trade subsidies, Environment, WTO

Trade subsidies affecting the environment

Introduction

The lack of compatibility between the policy of trade liberalisation and the principles of sustainable development,¹ while de-escalating the protectionist trade policies of Member Nations, has come up as a new challenge for the WTO. Free trade, as the primary objective of the WTO has led to the dismantling of trade barriers. This has undoubtedly created many business opportunities for the Member States. Ironically, it has also formed an inverse relationship between industrialisation and a healthy environment.

As a matter of fact, the problem of environmental pollution goes back to the early days of industrialisation, when industrial advancement was in its nascent stage. But during those times, the

¹ For protecting the environment

pollution impact on the environment remained within the limits of natural assimilation. The unregulated promotion of free trade has affected the natural cyclical rejuvenation of the environment. Apart from creating more opportunities for trade among the Member States, free trade is also being used as an opportunity to maximise profit, thus leading to superfluous industrialisation. This unchecked industrialisation has undoubtedly effected the quality of the environment.

The promotion of free trade, without checks and balances, has led, not only to economic inequalities of various kinds but has created adverse effects of far-reaching implications. The unregulated market competition generated by the free trade has led to the use of trade subsidies beyond the permissible limits of the WTO by both the Developed and the Developing countries. The Developed nations resort to subsidies mainly to produce high end products, for example, un-restrained subsidies to the Boeing Company for manufacturing commercial aircraft at the market competitive level by the United States, and similarly, subsidies to the Airbus Company by the European Union. On the other hand, Developing countries enjoy the relaxation to use trade subsidies mainly for establishing a basic infrastructure for industries. But the use of subsidies by the Developing countries to compete with the markets of other Developing or Developed countries is rather trade distorting and is therefore not justifiable under the WTO system. The consequences of the trade subsidies are not only confined to market competition but have impacted on human and environmental relationship also. For the purpose of analysing from the WTO perspective, link between trade subsidy and its effect on the environment can be established at a certain level of abstraction. It is the case that at the initial stage, the affect of trade on the environment is not noticeable until several years have gone by. The primary reason regarding the causes of the adverse effects on the environment from trade can be deduced from the variance in the Member Nations approaches when adopting environmental standards. This non-uniform adoption is an inducing factor for the multinational companies to make trade their preference even at the cost of a safer and sustainable environment.

Developing nations have their own explanation for the flexibilities adopted with regard to the environmental standards. The foremost challenge for the Developing nations is to sustain their overwhelming population, and this has forced them to follow unregulated industrialisation. Sweeping industrialisation as a result of free trade has created tough competition in the market everywhere.

Developed nations, are also in search of opportunities to save their business interests. This has led to the shifting of production from the Developed nations to the Developing and Less-Developed countries so that the products can be produced at a lesser expense. This variance in adopting environmental values by the Member States seems to encourage for trade bargains. Comparing this position in the context of the WTO, it seems that this form of trade benefits is having similar characteristics to that of the indirect form of subsidies as defined under the ASCM. Seeking trade benefits in a disguised form or through an indirect manner is contrary to the ASCM provisions. The term “benefit” explained in Article 1.1 (b) of the ASCM refers to some form of financial benefit or price support to the recipient.² Non-committal approach to the environmental standards for the cheaper production is comparable to the kind of trade benefit mentioned in the ASCM. Although the trade benefits obtained at the cost of the environment are not covered in the ASCM, nevertheless, from the relevant illustrations, the effect of the working of free trade is clear enough, if one follows the specific industries such as, the dismantling of ships and the effect of subsidies on the fisheries Industry. The reason for the shift in these industries, from the Developed to the Developing country, arises from the possibility of the economic advantages created, as the environment standards are not followed at the same level in the Developing countries as in the Developed countries. Ironically, short-term economic gains prevail over the environmental standards.

Dismantling of ships

Asbestos, one of the substances left behind after the dismantling of a ship, is health hazardous. The waste released from the discarded ship at the time of dismantling is mainly

- 1) Asbestos powder that is used for insulation.
- 2) Asbestos trapped in the coatings.

²Macrory, Patrick F.J., Arthur E. Appleton and Michael G Plummer, *The World Trade Organization, Legal Economic and Political Analysis*, Volume 2. New York. Springer publications. United States, 2005.p.692, ISBN:978-0-387-22685-9

In the Developed countries, taking into consideration the environment and health safeguard measures, the accessible part of the harmful pollutant is first isolated and then removed before dismantling a ship. This entire process of first separating the hazardous waste is expensive. In the Developing countries as an instance of unreasonableness, only the substances that can be removed without much of the expenses are removed. The rest is left as it is. It means that the scrap, mainly ferrous metal which can be reused is all that is taken off. Of course, one explanation for such a lenient attitude adopted (usually by the Developing countries) is the lack of technical knowledge and impropriety in the enforcement of environmental regulations because the legal policies for protecting the environment have no impact. Substances like asbestos are not made ineffective, consequently, leading to health complications such as, asbestosis and lung cancer.

The Case of Clemenceau ship³ as an example

In 2003, the French state handed over the “Clemenceau’s” hull to the ship-decommissioning industry. The decommissioned ship was sent to India for dismantling. The French government claimed that altogether the ship contained no more than 160 tonnes of asbestos of which 115 tonnes had been removed. However, the fact was that the exact nature and quantity of the hazardous materials on board the Clemenceau was difficult to ascertain as the French government failed to accomplish even the basic pre-requisite step of estimating the extent of hazardous waste prior to the export. This was in violation of the “Basel/Basle convention” to which both France and India are parties. So India was also responsible for allowing the Clemenceau to be dismantled at Alang,⁴ the shipbreaking yards. “The Basel/Basle Convention requires that no trans-boundary movement can occur without assurances that the destination facility is engaged in the environmentally sound management as defined in the convention.”

A requirements laid down in [Article 4, paragraph 2(e) and (g)]⁵ of the Basel/ Basle Convention.

Finally, the matter was brought before Pollution Control Board by the Gujarat (a province of India) and subsequently also supported by the Basel Action Network.⁶ Initially, permission for the dismantling of the decommissioned aircraft-carrier Clemenceau was granted by the government of India. Clause 2 of the agreement between the French government and the SDI i.e (ship decommissioning industry) is as follows.

“On completion of this operation, the hull shall be exported to the ship yard for asbestos removal and ship-breaking purposes. Technopure, the French asbestos removal company, shall transfer its technology and know-how to the Luthra Group, the asbestos removal company, as a part of which the Indian operators shall be trained during the major asbestos removal operation conducted in Toulon and be familiarised with the equipment’s and techniques at the level of European standards. The final asbestos removal operation shall be carried out under the oversight and supervision of the French asbestos removal company.”

But what happened in practice was contrary to what has been stated. The French Government claimed that there were no more than 160 tonnes of asbestos of which 115 tonnes have been removed. With regard to PCB (poly-chlorinated biphenyls) another hazardous substance,⁷ the French

³ http://www.ban.org/pdfs/ban_clemenceau_summary_of_violations.

⁴ For detail reference see, www.business-standard.com/india/news/alang-yard [*Business Standard*, Tuesday, August 07,2012]

⁵ Each party shall take appropriate measures to 2(e). Not to allow the export of hazardous wastes or other wastes to a state or group of states belonging to an economic and /or political integration organization that are parties, particularly developing countries, which have prohibited by their legislation all imports, or if it has reason to believe that the wastes in question will be managed in an environmentally sound manner, according to the criteria to be decided on by the parties at their first meeting;

(g) Prevent the import of hazardous wastes and other wastes if it has reason to believe that the wastes in question will not be managed in an environmentally sound manner.

⁶ Basel Action Network (BAN) is a non-governmental organization (NGO) whose mission is to prevent the globalisation of the toxic chemical crisis. BAN is based in Seattle, Washington, USA.

⁷PCB is chemically stable/inert, heat resistant and non-flammable substance, which is used worldwide as a dielectric in electrical components (transformers and capacitors).Due to its low biodegradability in the environment and their tendency to

government failed to accomplish even the basic requisite step of declaring it to Egypt (the transit state) and to India the country to which the ship was finally destined.

Basel Action Network, challenges the French government as they had failed to quantify the amount of hazardous material and were acting in contradiction of the Basel Convention.

Eventually, the French government was found guilty of its attempts to tamper with International obligations under the Basel Convention of 1989. This case is an example, how the Developed country had tried to seek trade benefits without caring about its environmental and health effects on the people of the Developing country. This practice can be compared with the subsidies defined under the WTO's SCM Agreement. It can be legally presumed that Developing countries violating the environment commitments for obtaining the trade benefits are equally liable. The presumptions are, these types of benefits are no different from the non-permissible subsidies, within the ambit of the ASCM of the WTO law, provided by the Member State. This example also shows how the Developed countries in collaboration with the Developing nations are pursuing trade interests on a bilateral basis forgoing the objectives of sustainable development.

Gains in trade but loss in the environment: analysed from the WTO perspective

Within the WTO trading system, there is no such specific agreement dealing with the effect of free trade on the environment. Nevertheless, the inequitable impact of trade on the environment needs to be checked.

To understand the underlying reasons for how trading effects the environment, we shall consider it by dividing into various stages. The trading pattern system can be categorised into primary and secondary stages. In the primary stage, there is a permissible limit for the use of subsidies within the WTO trading system. The primary stage deals with the establishment of a firm and the methods of production. The secondary stage covers the effect of trade practices between the nations, referring here specifically to the Developed and the Developing countries. When an industry is at the preliminary stage, subsidies help the industry to grow so as to establish the basic framework of the industry. There are legal provisions within the WTO's ASCM, supporting exemptions for the use of subsidies up to a restricted amount,⁸ which can be termed as a justifiable use of a subsidy.

The secondary stage covers the recent trade pattern, mainly between the Developed and the Developing countries. A link between the issue of trade benefits as a result of unregulated trade, and the losses caused to the environment can be established at this stage. With the promotion of the idea of free trade, trading activity between Developed and Developing nations has grown rapidly, but it has also overstressed the environment. This is also due to the lack of proper statute-based support for environmental standards in many of the Developing and Less-Developed countries.

Many nations, especially the Developing nations and the Less-Developed nations, lack the environmental norms to support the respective WTO policies of the sustainable development. This has further broadened the gap between the policies and practices among the Member Nations of the WTO. In the Developed countries, the environmental policies are strictly followed, whereas, the same is not the case with the Developing and the Less-Developed countries. The fact is that to support the required environmental standard, industries need to spend an extra amount or to pay extra taxes, which eventually increase the production costs of the goods. Therefore, by shifting the production bases to the Developing countries, where the environmental regulations are not strictly followed, they try to reduce the production costs of the products. The product produced at the lesser price in the Developing and Less-Developed countries can be sold at cheaper price by the Developed countries elsewhere. (as also mentioned in section 2) The trade benefit so obtained is very much analogous to the "financial benefits" defined under the SCM Agreement. Although, not specifically mentioned, this type of trade advantage is in a way supporting domestic industries (of the developing countries) for exports and hence can be categorised as an actionable subsidies.⁹

bio-accumulation and bio-magnify, PCBs belong to the so called persistent organic pollutants (POPs). The Basel/Basel Convention strictly regulates the trans-boundary movements of hazardous wastes and their disposal.

⁸Article 27 of the Agreement on Subsidies and Countervailing Measures (Special and differential treatment of Developing Country members).

⁹Matsushita, Mitsuo., Thomas J. Schoenbaum and Petros C. Mavroidis, *The World Trade Organization: Law Practice and Policy*. Oxford University Press, Great Britain, 2003 .p. 278. "Actionable subsidy" Actionable subsidies can be categorized as 1) the scheme must represent a financial assistance by the government, confer a benefit to a recipient and be specific; and

Providing subsidies for the promotion of trade are restricted under the WTO SCM Agreement, as this distorts the principles of fair trade, though not explicitly mentioned under the SCM Agreement. Nevertheless, (fair-trade) is an underlying objective for if this threat is not checked it may damage the basic objectives expected through the promotion of free trade.¹⁰ On the other hand, in order to maintain a balance between a justifiable uses of subsidies and non-justifiable uses, there are regulatory provisions in the ASCM.

Whether the trade “benefits” achieved by abrogating environmental standards be compared with the form of “benefits” described under the ASCM in the category of “actionable subsidy” is a crucial question for determining the balance between free trade and sustainable development. In its present form, the WTO’s ASCM deems it to be a subsidy, in which a benefit is conferred in one way or the other related to financial gain by that industry. Moreover, to be actionable, the benefit should be specific and beyond the limits stipulated under the ASCM agreement. For the type of “benefit” to be included in the definition of subsidy, it should be any form of income and “price support” in the sense defined under Article XVI of the GATT. The ambit of the term “price support” in the context of subsidies also covers the tax revenues to be forgone by the government.

Now, how this trade subsidy gets linked to the environmental issue or saying it the other way round, whether distorting environmental standards for the purpose of trade benefits can be considered as “subsidies,” needs some kind of reconsideration by the WTO administrative bodies so that the effect of trade liberalisation policies on environment can be measured.

Earlier, the agreement on the SCM, (subsidies and countervailing measures) under the WTO, classified subsidies into three parts 1) Prohibited subsidies, 2) Actionable subsidies and 3) Non-actionable subsidies. This type of classification created some policy space for wider flexibilities in order to use the subsidies.

Previously, subsidies given by the state to maintain environment standards, was covered under the category of non-actionable subsidy.¹¹ With the current changes in the ASCM,¹² the non-actionable subsidies are obsolete.

In these like situations due to the lack of clear cut regulatory provisions, contextual construction is formulated by taking various provisions of the ASCM so as to find out the impact on the environment due to the trade practices. Furthermore, such trade advantages obtained at the cost of the environment can be linked in monetary terms with the assumed value of subsidies. What is suggested, that the ambit of the term benefit within the ASCM be widened so as also to cover the trade advantages obtained at the cost of environmental standards.

Balancing trade and environment: a complex issue for the WTO

With the aim of achieving a free trade market system at the global level along with the sustainable development, the WTO has linked trade and environment issues. Accordingly, along with the trade, the Member States also need to follow a certain level of environmental standards, but this does not automatically establishes any equilibrium position between trade and environment. Attempts to create balance between free trade and sustainable development has caused ambiguities among the Member States. Developing nations are sceptical when it comes to making a balance between trade

2) the subsidy must not constitute either a prohibited subsidy or a non-actionable subsidy. Additionally, for a scheme to be an actionable subsidy, it must cause adverse effects to the interests of the WTO members.

¹⁰Article 3 of SCM, “Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited.”

- (a) subsidies contingent, in law or in fact, whether solely or as one of the several other conditions, upon export performance, including those illustrated in Annex I;
- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of the domestic over imported goods.

Article 3.2 “A member shall neither grant nor maintain subsidies referred to in paragraph 1”

¹¹The provisions regulating the non-actionable subsidies has expired by virtue of Article 31, which states “The provisions of Para 1 of Article 6 and the provisions of Article 8 and Article 9 shall apply for a period of five years, beginning with the date of entry into force of the WTO Agreement. Not later than 180 days before the end of this period, the committee shall review the operation of those provisions, with a view to determining whether to extend their application, either as presently drafted or in a modified form, for a further period.

¹²The provisions regulating these actionable subsidies expired at the end of 1999 subject to Article 31 of ASCM.

and environment, the reason being that following environmental standards at the same level as that of the Developed nations will off-set the meagre amount of trade profits. For the Developing countries there is no alternative choice in this situation, as free trade and investment from the Developed economies are intertwined and investors from the Developed nations in order to promote their industries try to push forward their own terms and conditions.

Practically, it seems, hard to attain a balance between trade and environment preferences, as it is difficult to make a choices between the two, on several occasions. This type of complicated situation also arose during the Doha conference. The reference here is to “Para 31” of the Doha conference,¹³ which broadens the scope of sustainable development and is based on “special trade obligations” (STO herein after). Although one can say that the STO within the framework of the MEA (multilateral environment agreement) is an attempt to create some sort of compatibility between the MEA and the WTO. The STO, the approach proposed by the E.C, which categories various trade obligations according to their specificity, seems to be favouring more the interest of the Developed nations. Developing nations are in need of foreign investments for development and for generating employment, Developed nations use this as a bargaining power. The WTO as an institution is trying to ensure that free trade need not make the irreparable damage to the environment. So, besides the several legal provisions of the agreements, creating obligation on the Member States to follow environment measures, various WTO conferences and the DSB (Dispute Settlement Body) also act to create harmony between trade and environment.

Despite several efforts to create balance between trade interests and environment measures, there still remain several grey areas, where the law is silent. Member Nations of the WTO try to promote their own trade interest, through these grey areas. For instance, the MFN clause that is included in the WTO to support the idea of free trade, allows market policies within the Member Nations to be based on no discrimination between “products” and “like products.”¹⁴ Additionally, this provision emphasizing invariable market attitude is quite general and does not regulate the process of making a product. Within the MFN clause, there are no sub-clauses to establish procedures for checking the process of making a product. The provision does not cover the qualitative aspect of production, specifically the environment standards expected to be followed during the time of production. Ironically, questioning the production-process method has often led to an scepticism that perhaps it can lead to an arbitrary protectionism.¹⁵ This is the situation where Member Nations become polarised and think in terms of short term gains rather than the issues of long-term consequences such as to maintain environmental standards.

The attainment of a balance between free trade and sustainable development has also faced odds due to the technicalities in the procedural aspects of treaty interpretations and the sovereign principles of the nations. Attempting to link environment measure with trade policies, by adding special regulatory condition based clauses to MFN principles, such as ISO standards and Global Eco labelling has generated the counter arguments from the Developing nation’s side, “that perhaps it is

¹³ Para 31 of the DOHA conference(2001) With a view to enhancing the mutual supportiveness of trade and environment, we agree to negotiations, without prejudging their outcome, on: (i) the relationship between existing WTO rules and specific trade obligations set out in multilateral environmental agreements (MEA). The negotiations shall be limited in scope to the applicability of such existing WTO rules as among parties to the MEA in question; (ii) procedures for regular information exchange between MEA Secretariats and the relevant WTO committees, and the criteria for the granting of observer status; (iii) The reduction or, as appropriate, elimination of tariff and non-tariff barriers to environmental goods and services. We note that fisheries subsidies form part of the negotiations provided for in paragraph 28.

¹⁴ Products and like products here refer to the domestic product and the same type of imported products.

¹⁵ *India etc versus U.S Shrimp-turtle (DS-58) case*. [In 1997, India Malaysia, Pakistan and Thailand brought a joint complaint against a ban imposed by the U.S on the importation of certain shrimp and shrimp products. The protection of sea turtles was at the heart of ban. The US Endangered Species Act of 1973 listed as endangered or threatened the five species of sea turtles that occur in US waters, and prohibited their “Fishing” within the US, in its territorial sea and high seas. Under the act, the US required that US shrimp trawlers use “turtle excluder devices” (TEDs) in their nets when fishing in areas where there is a significant likelihood of encountering sea turtle. The US lost the case, not because it sought to protect the environment but because it discriminated between WTO members. It provided countries in the Western Hemisphere-mainly in the Caribbean-technical and financial assistance and longer transition periods for their fishermen to start using turtle-excluder devices. It did not give the same advantages, however, to the four Asian countries (India, Malaysia, Pakistan and Thailand): they filed the complaint with the WTO.

the imposition of one country's national policies on another country's sphere of domestic jurisdiction." This can also be construed from the Appellate Body of the WTO's legal reasoning in the Shrimp turtle case.¹⁶ This discrepant approach has raised a broader legal question concerning *the limitation of treaty application due to the sovereign principles of a state that are fundamental*.¹⁷ What further hinders the balance between free trade and sustainable development are the doubts among the Member States that perhaps these environmental standards are to influence the established domestic rules and an attempt to give them different interpretations suitable for the bigger economies.¹⁸

The WTO, functioning to achieve its objectives of free trade along with the sustainable development has tried to link trade and environmental issues so that ignoring either one of the two factors and moving forward with the other further complicate the situation. The recent trends in trade between Developed and Developing nations seem to make things even more complex.

As discussed above, the gaps in treaty provisions are being interpreted so that trade benefits of a certain group of countries have widened the ambiguities among the Member States rather than forming a balance. This is making the way for trade distorting subsidies to prevail over the environmental obligations. What is required that a uniform market pattern based on free trade and sustainable development, as an aspects of a single policy measure in which these two features are complementing each other.

A critique of free trade policy, the case of fisheries

Nations have been trading since the historical times based on two key assumptions. 1) Every product has an exchange value or a market price and 2) Nations trade to sell and buy products and to earn profits.

The economics of profit is the underlying principle on the basis of which every Member Nation tries to trade. This has led to the unregulated free trade in present day international trade practices.

The consequence of unregulated free trade can be seen in the fisheries industry. Unregulated free trade has led to the giving of subsidies to promote catching of fishes. But subsidies on fishing industry have led to an uncontrolled expansion of fisheries and resultantly significant decline in the fish stocks. Over-fishing is nowadays widely recognized as a growing threat to the sustainable management of the fishing resources. Empirical evidence shows that the use of subsidies on the capacity building measures for the purposes of fishing has led to overfishing. It has been found on

¹⁶ WT/DS58/AB/R, Para 177, "We have already observed that section 609, in its application, imposes a single, rigid and unbending requirement that countries applying for certification under Section 609 (b) (2) (A) and (B) adopt a comprehensive regulatory program that is essentially the same as the United States program, without inquiring into the appropriateness of that program for the conditions prevailing in the exporting countries. Furthermore, there is little or no flexibility in how officials make the determination for certification pursuant to these provisions. In our view, this rigidity and inflexibility also constitute 'arbitrary' discrimination."

¹⁷ Francioni, Francesco. *Environment, human rights and international trade*. Hart publishing, Oxford Portland Oregon. US, 2001 .p.13 edition 2001.

¹⁸ WT/DS231/AB/R, European Communities-Trade Description of sardines. [E]uropean Communities raised the issue of legal interpretation concerning the product the description of Sardines. In 1978, the Codex Alimentarius Commission (the "Codex commission"), of the United Nations Food and Agriculture Organization and World Health Organization, adopted a worldwide standard for preserved Sardines and Sardine-type products, which regulate matters such as presentation, essential composition and quality factors, food additives, hygiene and handling, labelling, sampling, examination and analyses, defects and lot acceptance. This standard, CODEX STAN 94-1981, Rev.1-1995("CODEX Stan 94"), covers preserved sardines or sardine-type products. This also included Section 6 of Codex Stan 94. Peru exports preserved products prepared from *Sardinops sagax* (Sardinops sagax), one of the species of fish covered by Codex Stan 94. This species is found mainly in the Eastern Pacific Ocean, along the costs of Peru and Chile. In appeal against the panel decision (para 35) The European Communities claims that the panel erred in concluding that Codex Stan 94 is a relevant international standard for purposes of Article 2.4 of the TBT agreement. The European Communities alleges further that the panel erred in law when interpreting the meaning of Codex Stan 94. According to the European Communities, the drafting history of Codex Stan 94 demonstrates that section 6.1.1(ii) of Codex stan 94 should be interpreted as allowing the common name for the species of fish to be a possible name for the preserved "sardine-type" product, and the word "sardine" does not have to be part of the name. Para 41, According to the European Communities, the EC regulation covers only *Sardina pilchardus* and does not regulate *Sardinops sagax*, nor fish of other species. The European Communities thus argues that the relevant part of Codex stan 94, for purpose of Article 2.4 of the TBT Agreement, is section 6.1.1(i), "which states that the name "Sardines" is to be used exclusively for *Sardina pilchardus*. According to the European Communities section 6.1.1(i) of Codex Stan 94 is used 2as a basis for" the EC regulation." The European Communities contend that section 6.1.1(ii) is not a relevant part of the standard because it refers to products that are not regulated by the EC regulation. Therefore it need not be used "as a basis for" the EC regulation.

the basis of case studies that there are programmes involving the provisions of loans and grants and risk-reduction programmes for vessel construction and modernization.¹⁹ Eventually, this has led to the depletion of several fishing species beyond the natural cycle of re-production level. We may take the cases of Canada, the EC, Japan and the US.

From 1954-1968, Canadian subsidies for fishing increased the capacity of the Northwest Atlantic offshore fishing fleet by more than 18 times, creating twice as much capacity as could be used for a sustainable level of catch. Despite the collapse of cod stocks, the Canadian fishery subsidy had increased the capacity to catch five times the original annual quota by 1989.

The EC and United States have also provided subsidies for their fishing fleet expansion and pursued a modernization programme which resulted in a further reduction of fish stocks. The United States used low-interest loans. The loan guarantees in the 1980s were for the construction of a large fleet of factory trawlers for the Alaska Pollock fishery of the Eastern Bearing Sea, the Aleutian Islands and the Gulf of Alaska. Japan has spent approximately US\$ 2 billion annually on fishing ports and villages. Such infrastructure projects are used by the fishing industry.²⁰ It was during the Doha conference, that the issue of fisheries subsidies was discussed emphatically and an attempt was made to find compatibility between trade and environment.²¹ The example of the impact on fisheries industry shows the effect of unregulated subsidies on the environment.

The emerging economies in these situations are facing tough market competition, so the priority is to save their markets. As a result environmental obligations are made a scapegoat by the use of trade practises such as subsidies. What is needful here is to regularise free trade, bearing in mind the urgent need to save the environment. But unregulated free trade has led to the measuring environment through the yardstick of cost and benefit which has negative implications in the long run for all of us.

Conclusions

Based on the discussions formerly made in this text concerning the balance between free-trade and the environment, it is proposed that the trade relationship among the Member States needs to be based on some assumed environmental standards acceptable to all the Member States of the WTO. But paradoxically, trade and environment share even an odd relationship. Free trade, along with sustainable development, should be considered as one common objective of the WTO. In order to achieve this, certain levels of basic environment obligations need to be followed on a priority basis by the industrial sector of both the Developed and the Developing nations.

Reforms in the WTO, in order to accommodate strict environmental measures are often advocated, but for their fulfilment it is needful that Member Nations consider this as a part of their socio-political objectives. This requires policy-reforms within their domestic legal system also so as to cover environment-related issues.

The primary objective of an industry is, (as discussed previously in the text) the trade benefits, and when it comes to the competitive business environment as a result of free trade then even either, by circumventing or abrogating the basic environment rules industrial sector pursues its interests. This form of "trade benefit" obtained has been compared with trade subsidies discussed under the ASCM. In the current scenario, it seems, as if the existing WTO provisions on subsidies are not adequate enough to deal with these kinds of trade measures where business interests overlap the values so as to preserve nature. The fact is that, there is no mention of environmentally-related trade benefits under the SCM Agreement. Perhaps the progenitor of free trade could not foresee the trade impacts on the environment. But now, with the deterioration of the environmental conditions due to the free trade,

¹⁹Porter, Gareth. *Fisheries Subsidies and Over Fishing: Towards a structured Discussion*, United Nations Environment Programme ISBN No: 92-807-2126-7. UNEP publications. Geneva. Switzerland, 2001. p. no11.

²⁰Ibid note, 19.p no 11, 12-28

²¹Para 28 Doha declarations " In the light of experience and of the increasing application of these instruments by members, we agree to negotiations aimed at clarifying and improving disciplines under the agreements on implementation of article VI of the Gatt 1994 and on subsidies and countervailing measures, while preserving the basic concepts, principles and effectiveness of these agreements and their instruments and objectives, and taking into account the needs of Developing and Less-Developed participants. In the initial phase of the negotiations, participants will indicate the provisions, including disciplines on trade distorting practices, which they seek to clarify and improve in the subsequent phase. In the context of these negotiations, participants shall also aim to clarify and improve WTO disciplines on fisheries subsidies, taking into account the importance of this sector to developing countries."

there seems to be a requirement for legal provisions within the ASCM, not only to regulate trade but also to compensate in economic terms the affected parties.

There is also an additional risk that putting too much emphasis on the environment standards can create a protectionist approach, which goes contrary to the objectives of free trade. Hence, an approach which can differentiate between the genuine grounds for trade restrictions versus protectionist propaganda needs to be adopted for the environment protection.

What can be suggested is a model that indicates the point when a optimum level of pollution control is reached and any further reduction can lead to the greater costs of production and of less effective pollution control. The analysis of the subsidies to the fisheries industry specifies the far-reaching consequences of the unregulated subsidies to the fisheries industries. These un-regulated subsidies can create vital damages to the resources that we are depending on for our livelihood. The subsidies have encouraged overproduction and thus exacerbated many of the ecological problems linked to the overfishing and thus depleting it beyond the sustainable limit.

Apart from the foregoing analysis, we cannot ignore the positive side of using subsidies to promote trade. As the means of production is the base of free market-economies and Member Nations of the WTO are at the different economic situations.

Without considering sustainable development along with free trade, the trade practices will be guided by the Developed countries or by big economies. Subsidies-compatible with the environment can play a positive role in promoting for the environmentally consistent and fair methods for production. Additionally, subsidies to reduce emissions of greenhouse gases or environment friendly methods of production have some justification. This clearly indicates that there is a need to make changes in ASCM by including provisions for not seeking trade benefits at the cost of environment as the ASCM in its present form cannot support the objective of sustainable development along with free trade.

The WTO as an institution has the responsibility of exploring a wider role for creating a balance between trade subsidy and environment, where subsidies are used for confined objectives, not mainly for the promotion of trade but rather making the production method environmentally friendly. The WTO has an inbuilt judicial mechanism, as Dispute Settlement Body to implement environmentally friendly measures. Nevertheless, due to the lack of specific agreements in support of the environmental measures within the WTO, there are some limitations. As a result of this, the Dispute Settlement Body cannot take a strong line to secure the obligations of maintaining environmental standards. Finally, it can be said that there is a need for the WTO to promote the principles of sustainable development along with trade liberalisation. This is possible, once trade and environment are taken as mutually supportive factors for meeting the objectives of the WTO.

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