



# PROCEEDINGS



5<sup>th</sup> International Conference

*The Economies of Balkan and  
Eastern Europe Countries in the  
changed World*

9 - 12 May 2013  
Istanbul, Turkey



<http://ebeec.teikav.edu.gr>

organized by

Kavala Institute of Technology, Department of Accountancy, Greece

Istanbul University, Department of Economics, Turkey

# **CONFERENCE PROCEEDINGS**

## **EBEEC 2013**



**Proceedings of the 5<sup>th</sup> International Conference**

**“The Economies of Balkan and Eastern Europe Countries  
in the changed World”**

**EBEEC 2013**

**Istanbul, Turkey**

**May 9-12, 2013**

**Department of Accountancy and Finance**

**Kavala Institute of Technology**

**Kavala, Greece**

**ISBN: 978-960-363-043-2 - ISSN: 1792-4383**

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# ECONOMIC CRISIS IN GREECE: STUDENTS' WORST NIGHTMARE

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## ABSTRACT

During the last five years Greece has experienced the most serious financial crisis. Greece struggles to pay the debts it has built up in the previous decades. The consequences are enormous for the people, strict measures, taxes, poverty, and loss of jobs, unemployment, and even suicides. No simple answer to Greece's crisis seems to exist. The government and the political parties are not capable of changing the situation. Young people seem to be very skeptical and pessimistic about their lives. The present study aims to capture students' attitudes toward the economic crisis and its origin. In addition, it analyses their judgments of the effects on the distribution of income, the long term sacrifices and their expectations for the future. In particular, the paper reports the responses of 256 Greek students from the Pedagogical Departments in Greece. Principal Components Analysis was used for the data analysis. The results indicate, among others, political games and corruption as the major components of the crisis. Employment seems to trouble students, who face the challenge to immigrate to other countries.

## KEYWORDS

Economic, crisis, students, attitudes, PCA

## JEL CLASSIFICATION CODES

J17 - Value of Life; Forgone Income, I21 - Analysis of Education, J17 - Value of Life; Forgone Income

## 1. THEORETICAL FRAMEWORK

The international financial crisis started in the USA and spread all over Europe. As Bogdanova (2012) maintains, it is common truth that when the USA sneezes, the rest of the world has a cold. Frangos et al. (2012) argue that the crisis started in Greece in 2009, and consequently it was developed into a crisis of the whole Eurozone. According to Bogas and Tsoukas (2012), U.S.A.' financial crisis led to the collapse of many high-status financial and banking firms, and this situation started quickly spreading internationally. Many countries in Europe were exposed to the "toxic" financial products.

Ireland, Greece, Portugal, Spain and Italy face severe political, structural and economic problems. Kotios et al. (2012) argue that Greece is dealing with the deepest financial crisis; Portugal and Ireland are trying to achieve better results, to deal with it; Spain, Italy and Belgium have an uncertain future as they are in danger of having very high public debt. The main reasons for the crisis in Greece are based on Greek authorities' economic mismanagement, public money waste, tax evasion (De Gauwe, 2009; De Gauwe et al., 2009), high debts, fiscal deficits, political corruption etc. (Papadakis, 2010), and finally on the Eurozone authorities who did not provoke economic crisis to become a systemic crisis in the Eurozone (De Gauwe, 2009; De Gauwe et al., 2009), out-of control government borrowing and long-term economic weakness (Grant, 2009). The situation in Greece is so dramatic that Europe is skeptical whether Greece should march out of the Eurozone and return back to the drachma although there are too many risks of such a change (Taylor, 2011). Madhusudhanan (2012) reports that the current Greek crisis sets a serious question on the survival of Euro itself, and consequently the current crises in Europe are showing sign of Euro collapse. Greece was put under the supervision of the European Central Bank (ECB), the European Commission (EC) and the International Monetary Fund (IMF).

The major consequences of the Greek debt crisis are high rates of unemployment, decrease of salaries and incomes, loss of jobs and poverty, and young people being in desperate need of immigration. More specifically, the economic crisis initially psychologically affects children as individuals, who feel anxiety, insecurity and fear for the future with the overall situation. As students, they are unable to perform at school the way they should. This negative aspect applies because of the parents' disability to finance and support their studies. As a result, many students lose their opportunity to study and go to colleges. Furthermore, schools themselves have weaknesses and shortcomings, which significantly affect study quality. For example, due to the economic crisis there is less revenue for the operating costs of schools, and in many cases there is the financial burden of the parents, which makes all more difficult. Mergers segments are a fact, with even more students in public schools, and respectively teacher recruitment decrease is more and more common these days. As a result, the course is not as it should be and the construction of new schools may not be possible, efficient and appropriate to the 21<sup>st</sup> century's knowledge. According to Frangos et al. (2012), the effects of the economic crisis and corruption of the Greek political system on the way Greek young academic progress and expectations are: Loss of confidence in state institutions, democracy values, and political, judiciary, educational, health and security systems; Psychosocial characteristics, lack of goals, prevailing sense of abandonment, widespread pessimism, negative beliefs, nihilistic approach to everyday reality and lack of self-confidence, negative influence of the economic crisis on the results of the exams; Substantial reduction in living expenses (especially, on food, clothing, housing and entertainment); Definite immigration plans by young educated Greeks, and desire for postgraduate studies and settlement abroad. Thus, the present study views to examine students' points of view to this situation.

## **2. AIM OF THE STUDY**

The present study aims to explore students' attitudes toward the economic crisis, its origin and causes. In addition, it analyses their beliefs on the effects of the distribution of income, the long term sacrifices, and their expectations for the future. In particular, the paper reports the responses of 256 Greek students from the Pedagogical Departments in Greece.

## **3. THE INSTRUMENT**

For the purpose of the present study a 27-item scale was developed to evaluate Greek students' perceptions toward the economic circumstances in Greece and called it *Economic Crisis Scale* (Table 1). The scale seeks to clarify students' attitudes and beliefs in relation to Greek economic grounds (e.g., Economic crisis as part of a global political game), to potential recovery of Greek economy (e.g., The state/government is incapable of making investments and offering solutions), to consequences on Greek economy and people's life (e.g., There is no future prospects in Greece), and finally, to economic consequences on personal life (e.g., The prospect of creating a family is almost impossible).

## **4. SAMPLE**

The sample of population was 256 students from the Pedagogical Departments from the University of Macedonia and Western Macedonia. 96 (37.5%) were males and 160 (62.5%) females. As regards the year of studies, 157 (61.3%) were first year students, 32 (12.5%) second year, 35 (13.7%) third year, 30 (11.7%) fourth year students and finally 2 (0.8%) were before graduation.

## **5. RESULTS**

*A. Principal components analysis of the Economic Crisis Scale:* The study was conducted in March 2013. 256 valid questionnaires were collected. The size of the sample is quite satisfactory, as it is 8 times the sum

of the questions of the questionnaire. The KMO index for sample adequacy,  $KMO=0.896>0.60$ , showed that the data of sample were suitable for factor analysis and the Bartlett's Test of Sphericity (Bartlett's sign  $<.01$ ) showed that Principal Components Analysis is appropriate.

Based on the analysis results (Table 1), 4 uncorrelated factors explain the 79.534% total data inertia and those are described separately afterwards. Cronbach's  $\alpha$  is statistically significant and equal to 83.7% for the total SCALE. The reliability index (Cronbach's  $\alpha$ ) is statistically significant and equal to 87.6%, 79.8%, 80.6% and 76.9%, for the 1st, 2nd, 3rd, and 4<sup>th</sup> component respectively. Finally, the values of common factor variance (Communality) for each item were bigger than 0.50, which declares satisfactory quality of measurements from the sample-model of the 4 components. Moreover, the model of the 4 components implies construct validity of the model (Cao & Dowlatshahi, 2005; Anastasiadou, 2006). In addition, almost every item, loads to it more than 0.50, which implies convergent validity.

More specifically, on the basis of the students' attitudes, as it resulted from the Principal Components Analysis, the component F1, with eigenvalue 7.563 which explains, following Varimax rotation, 28.010% of the total variance, includes mainly questions Qa1, Qa2, Qa3, Qa4, Qa5, Qa6 and Qa7, with very high loadings (0.936, .0859, 0.833, 0.813, 0.769, 0.687, 0.680) (Table 1).

The first component sketches out the following students' opinions, which are: Economic crisis is a part of a global political game (Qa1) ( $M=4.38$ ,  $sd=0.697$ ), The role of the markets and the banks on an international level contributed to the economic crisis (Qa2) ( $M=3.88$ ,  $sd=0.782$ ), Political corruption in Greece is responsible for the economic crisis (Qa3) ( $M=4.13$ ,  $sd=1.055$ ), Lack of political responsibility and political control in Greece lead to the economic crisis (Qa4) ( $M=4.00$ ,  $sd=0.708$ ), The economic crisis is a consequence of the weakness in the administration of justice (Qa5) ( $M=3.88$ ,  $sd=1.055$ ), The political and economic scandals caused the economic crisis (Qa6) ( $M=4.25$ ,  $sd=0.831$ ), Lack of meritocracy is a cause of the economic crisis (Qa7) ( $M=4.25$ ,  $sd=1.201$ ), (Qa8) ( $M=3.75$ ,  $sd=1.201$ ). This factor highlights the causes of economic crisis in Greece. More specifically, all the above items that lead to the construction of the first component have a mean value ranging 3.75 to 4.25, which shows that the level of Greek students' beliefs toward the economic crisis causes is at a high level. The reliability of economic grounds factor is  $\alpha=0.863$ , and is particularly satisfactory.

Using T-test for independent samples, it is shown that there is significant difference between economic grounds and students' gender ( $t=-10.062$ ,  $df=254$ ,  $p=0.000<0.05$ ). Thus the economic grounds factor is influenced by the students' gender. In addition, ANOVA test showed the economic grounds factor is influenced by the students' year of study ( $F=4.800$ ,  $p=0.000<0.05$ ).

**Table 1.**Principal Component Analysis

Items- questions	Factors						sd
	F1	F2	F3	F4	Communality	M	
Qa1: Economic crisis as part of a global political game	0.936				0.864	4.38	0.697
Qa2: The role of the markets and the banks in an international level contributed to the economic crisis	0.859				0.897	3.88	0.782
Qa3: Political corruption in Greece is responsible for the economic crisis	0.833				0.928	4.13	1.055
Qa4: The lack of political responsibility and political control in Greece lead to the economic crisis	0.813				0.706	4.00	0.708
Qa5: The economic crisis is a consequence of the weakness in the administration of justice	0.769				0.870	3.88	1.055
Qa6: The political and economic scandals caused the economic crisis	0.687				0.797	4.25	0.831
Qa7: The lack of meritocracy is a cause of the economic crisis	0.680				0.761	3.75	1.201
Qb1: The future prospects of political and economic recovery are nonexistent		0.939			0.903	4.00	0.501
Qb2: The economic ability of the Greek people is constantly diminished		0.856			0.772	4.63	0.485

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Qb3: Greece will be lead to bankruptcy		0.832			0.636	3.55	0.831
Qb4: The state/government is incapable of making investments and offering solutions		0.819			0.494	4.13	0.601
Qb5: Unemployment is multiplied		0.677			0.867	3.75	0.434
Qb6: Private sector activity and business creation are zeroed		0.632			0.897	3.25	0.663
Qb7: Purchasing power disappears		0.596			0.656	3.00	1.120
Qb8: The private sector has foundered		0.587			0.979	3.38	0.697
Qc1: There is no future prospects in Greece			0.876		0.707	4.63	0.485
Qc2: There are no professional opportunities in Greece			0.799		0.475	4.13	0.601
Qc3: Unemployment leads to brain emigration to other countries			0.731		0.829	4.38	0.485
Qc4: Professional opportunities are possible only abroad			0.718		0.902	3.50	1.325
Qc5: Young people emigration is imperative			0.568		0.717	3.58	0.994
Qc6: Sacrifices made by Greek people are worthless			0.507		0.888	4.25	0.663
Qd1: Social interaction has been limited				0.918	0.837	2.88	0.782
Qd2: Outings have been limited				0.738	0.704	3.38	0.697
Qd3: Young people's dreams have frozen				0.660	0.783	4.25	0.434
Qd4: The future is uncertain				0.641	0.826	4.50	0.708
Qd5: The prospect of creating a family is almost impossible				0.560	0.798	3.00	1.002
Qd6: The prospects of sociopolitical change are slim				0.528	0.979	3.63	0.485
Eigenvalue	7.563	6.185	4.278	3.448			
Variance Explained %	28.010%	22.907%	15.846%	12.771%			
Cronbach's a	0.863	0.824	0.806	0.787			
Total Variance Explained %	79.534%						
Total Reliability Cronbach's $\alpha$	83.7%						

The second component F2, with eigenvalue 6.185, which explains, following Varimax, 22.907% of total dispersion includes questions Qb1, Qb2, Qb3, Qb4, Qb5, Qb6, Qb7 and Qb8, with very high loadings (0.939, 0.856, 0.832, 0.819, 0.677, 0.632, 0.596, 0.587) (Table 1). In the component F2 the attitudes on the future prospects of financial recovery are presented. More specifically, they highlight the options that are: The future prospects of political and economic recovery are nonexistent (Qb1) (M=4.00, sd=0.501), The economic ability of the Greek people is constantly diminished (Qb2) (M=4.63, sd=0.485), Greece will be led to bankruptcy (Qb3) (M=3.55, sd=0.831), The state/government is incapable of making investments and offering solutions (Qb4) (M=4.13, sd=0.601). Therefore, students believe that Unemployment is multiplied (Qb5) (M=3.75, sd=0.434). In addition to that, students declare that Private sector activity and business creation are zeroed (Qb6) (M=3.25, sd=0.663), Purchasing power disappears (Qb7) (M=3.00, sd=1.120), The private sector has foundered (Qb8) (M=3.38, sd=0.697). This factor expresses the most pessimistic view in relation to potential recovery of Greek economy. More specifically, all the above items that lead to the construction of the second component, but q1 and q8, have a mean value range 3.00 to 4.63, which shows that the level of Greek students' pessimistic attitudes is at a moderate to high level. The item Qb2 with mean value (M=4.63) and the item Qb4 with mean value (M= 4.13) show quite a high level of pessimistic view. The reliability of this component is  $\alpha=0.824$ , and it is also very significant.

Using T-test for independent samples it is shown that there is significant difference between a pessimistic view in relation to potentiality of Greek economy and students' gender ( $t=21.622$ ,  $df=254$ ,  $p=0.000<0.05$ ). Thus the economy consequences pessimistic factor is influenced by the students' gender. In addition, ANOVA test showed the pessimistic factor is influenced by the students' year of study ( $F=156.7171$ ,  $p=0.000<0.05$ ).

The third component F3, with eigenvalue 4.278 which explains, following Varimax rotation, 15.846% of total variance includes questions Qc1, Qc2, Qc3, Qc4, Qc5 and Qc6, with particularly high loadings (0.876, 0.799, 0.731, 0.718, 0.568, 0.507) (Table 1). The third component is composed of students statements that are: There is no future prospects in Greece (Qc1) ( $M=4.63$ ,  $sd=0.485$ ), There are no professional opportunities in Greece, (Qc2) ( $M=4.13$ ,  $sd=0.601$ ). Their statements show that these students consider that Unemployment leads to brain migration to other countries (Qc3) ( $M=4.38$ ,  $sd=0.485$ ) Professional opportunities are possible only abroad (Qc4) ( $M=3.50$ ,  $sd=1.325$ ). It is worth mentioning that they express the conviction that Young people emigration is imperative (Qc5) ( $M=3.58$ ,  $sd=0.994$ ) and the Sacrifices had been made by Greek people are worthless (Qc6) ( $M=4.25$ ,  $sd=0.663$ ). This factor expresses the tremendous consequences on Greek economy. More specifically, all the above items that lead to the construction of the third component, have a mean value ranging from 3.50 to 4.63, which shows that the level of negative consequences on Greek economy is at a high level. The reliability of the third component is  $\alpha=0.806$ , and is significant.

Using T-test for independent samples it is shown that there is significant difference between negative consequences on Greek economy and students' gender ( $t=2.943$ ,  $df=254$ ,  $p=0.004<0.05$ ). Thus the negative consequences factor is influenced by the students' gender. In addition, ANOVA test showed that the negative consequences factor is influenced by the students' year of study ( $F=11.855$ ,  $p=0.000<0.05$ ).

The fourth component F4, with eigenvalue 3.448 which explains, following Varimax, 12.771% of total dispersion includes questions Qd1, Qd2, Qd3, Qd4, Qd5 and Qd6, with particularly high loadings (Table 1).

In the component F4 the attitudes toward students' personal life are presented. More specifically, the second factor sketches out the following students' opinions, which are: Social interaction has been limited (Qd1) ( $M=2.88$ ,  $sd=0.782$ ), The prospect of creating a family is almost impossible (Qd2) ( $M=3.38$ ,  $sd=0.697$ ), Outings have been limited (Qd3) ( $M=4.25$ ,  $sd=0.434$ ), Young people's dreams have frozen (Qd4) ( $M=4.50$ ,  $sd=0.708$ ), The future is uncertain (Qd5) ( $M=3.00$ ,  $sd=1.002$ ) The prospects of sociopolitical change are slim (Qd6) ( $M=3.63$ ,  $sd=0.485$ ). This component expresses economic consequences on young people's personal life.

More specifically, all the above items that lead to the construction of the second component, but q1 and q8, have a mean value ranging from 2.88 to 4.50, which shows that the level of Greek students' perceptions regarding economic consequences on their personal life is at a moderate to high level. The item Qd4 with mean value ( $M=4.50$ ) and the item Qd3 with mean value ( $M=4.25$ ) show a quite high level of pessimistic views. The reliability of the fourth component is  $\alpha=0.787$ , and is significant.

Using T-test for independent samples it is shown that there is no significant difference between economic consequences on personal life and students' gender ( $t=-0.783$ ,  $df=254$ ,  $p=0.434>0.05$ ). Thus morality factor is not influenced by the students' gender. In addition, ANOVA test showed that factor of economic consequences on young people's personal life is not influenced by the students' year of study ( $F=142.875$ ,  $p=0.000>0.05$ ).

## 6. CONCLUSIONS

It is a fact that Greece is going through a period of severe economic crisis, which as time passes makes daily life difficult. Apart from the practical changes, brought about in the living standards of many families, the economic crisis affects all community sectors in general. It is an undisputed fact that the education sector is affected through this significantly. Greek students argued that legislative, executive and juridical power have a major part in fiscal crisis and political corruption. The government and the political parties are not capable of changing the situation. Young people seem to be very skeptical and pessimistic about their lives. As Frangos et al. (2012) stated 'The Greek debt crisis is ruining the lives, dreams and future prospects of the Greek youth' and puts the country and its future in great jeopardy. In light of this evidence, the economic

crisis affects the education sector, and does not help evolution, but with appropriate measures to remedy the current problems that exist in the educational system, we hope that it could be reduced in the future.

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# PERCEIVED BRAND QUALITY AND BRAND LOYALTY TOWARDS DIFFERENT BRANDS OF MOBILE PHONES

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## ABSTRACT

Brand equity, is defined as the marketing effects or outcomes that accrue to a product with its brand name compared with those that would accrue if the same product did not have the brand name. This implies that brands vary in amount of power and value they have in customer's mind. Thus it can be inferred that a powerful brand has got higher brand equity as compared to rival brands. This era has made mobile phones as indispensable companions for everyone, despite the customers belonging to any class of society, culture or nation. A study showed that the biggest segment of mobile phone users is said to be students of colleges and universities. Accordingly, the author developed a study at an international university. Given the importance of brand equity regarding mobile phone usage among students, this study aims to assess the equity of global mobile phone brands among the students. This study is largely focus on analyzing perception of students belonging to different cultural backgrounds in relation to two dimensions of brand equity such as perceived brand quality and brand loyalty.

**KEYWORDS:** brand, brand Quality, brand loyalty, mobile brands

## JEL CLASSIFICATION CODES

M31, M37

## 1. INTRODUCTION

This research throws light to find national cultural influences, if any, on perception of two dimensions of brand equity, namely 'perceived brand quality' and 'brand loyalty'. By the use of survey questionnaires students of Umeå University were asked, as customers from various cultures, about their perceived brand quality and brand loyalty towards different brands of mobile phones.

### 1.1 Background of the Study

The society in which one lives shapes ones attitude, behavior, values and norms which further give rise to different perceptions, choices and preferences one makes in certain circumstances. In other words, one societal culture is distinct and identifiable from another culture. So we can say that people belonging to different nations are exposed to different set of cultures which in turn influence their tastes, choices and preferences (Rucker et. al 2012).

In this context, if people are asked about their preferences for global mobile phone brands, it is highly expected that they will tend to choose the one which is most popular and preferred in the culture they live. Similarly, understanding why customers from different national cultures choose a particular brand of mobile phone becomes an interesting topic and various researchers have argued that this line of business is considered to be highly profitable (Karjaluto et al.2005). In mobile phone business, the large user segment that has been identified consists of students at colleges and universities; therefore this segment needs special attention from brand sellers as it contributes the most in overall profit share.

## 1.2 Purpose

The aim of this research is to conduct a study among students of Umea University that represent various cultures in order to identify the brand equity of global mobile phones which mainly include Nokia, Siemens, Motorola, Sony, Samsung and Apple. It will largely focus on analyzing perception of students belonging to different cultural backgrounds in relation to two dimensions of brand equity – ‘Perceived Brand Quality’ and ‘Brand Loyalty’.

## 1.3 Problem Identification

As a result of the fierce competition and constant technological change that exists in the mobile phones market, the landscape of market share ranking has been dramatically changing amongst competitors. Thus, building and properly managing brand equity has become essential for most companies (Liaogang et al. 2007) in order to defend their market position and share. More and more companies have already realized that brand equity is one of their most valuable intangible assets which need to be constantly monitored.

On the other hand, this era has made mobile phones as indispensable companions for everyone, despite his/her belonging to any class of society, culture or nation. The most noted segment of mobile phone users is said to be students of colleges and universities. This segment’s discussion and choice, however, remain among ‘mobile phone brands’ (Liu, 2002) rather than ‘service providers’, most popular of which include Nokia, Siemens, Sony, Samsung, Motorola and Apple

It has also been well documented that national culture can influence both customers’ attitude and behaviors. More specifically, researchers have argued that national culture has an effect on consumer-reported “proneness” to brand loyalty and finds that those who scored highly in individualism and uncertainty avoidance have greater affinity for exhibiting loyalty to a brand (Taylor, Celuch and Goodwin, 2004, p. 217).

Jung and Sung (2006) further argued that consumers in different country/culture are expected to be different in terms of the way they perceive international brands, e.g. attributes they associate with those brands in their memories. It is because images and symbolic meanings attached to brands are shaped by a local society/culture where economic and social values of a brand might vary greatly based on collective ideas about the brand. This fits well in the situation of mobile phone brand equity if it will be applied on students of Umea University which has many international students. Based on the above argument it can be inferred that these students hold diverse symbolic meanings and perceptions about the different mobile brands as they belong to different national cultures.

Summing up, there is a need to initiate a study which finds out if students from different national cultures really have different perceived brand quality and brand loyalty for mobile phones. Consequently, based on these findings, strategies can be devised on how mobile phone companies can reach the most appropriate market segments.

## 1.4 Research Question and Hypothesis

The above discussion leads us to the following research question for the present study:

Do different national cultures represented by students at Umeå University influence their perception on value of perceived brand quality and brand loyalty of mobile phones?

**H<sub>1</sub>:** There is a relationship between the national cultural background and brand loyalty.

**H<sub>2</sub>:** There is a relationship between the national cultural background and perceived brand quality.

## **2. LITERATURE REVIEW**

This section will consider general theory related to brand equity and specific theory related to perceived brand quality and brand loyalty and how they are linked with national cultural influences.

### **2.1 Overview of Brand Equity**

Brand Equity as a concept has attracted much attention during the last few decades. Defined as the marketing effects or outcomes that accrue to a product with its brand name compared with those that would accrue if the same product did not have the brand name (Keller, 2003), implies that brands vary in amount of power and value they have in the customer's mind. Thus, it can be inferred that a powerful brand has got higher brand equity and higher sales as compared to rival brands. It has been further highlighted by Liu (2002) that brand equity is a multidimensional concept which is strongly associated with higher brand loyalty, brand awareness, perceived quality and strong brand associations.

### **2.2 Brand Loyalty and National Culture**

Traditionally, research into brand-loyalty has focused on behavioral measures that include purchase-sequence, proportion-of-purchase, and probability-of-purchase (Lee 2005). In relation to that it can be inferred that brand-loyalty refers to the degree to which a customer repetitively chooses the same brand. One important factor which is closely linked to brand loyalty is national culture. Researchers have argued that the overall evaluation of products are usually influenced by country stereotyping, that is, the image that the consumers have about a certain brand in a particular culture highly influences their perceptions of products based on specific culture (Yasin et al. 2007).

Apart, usually customers prefer brands over others, because they are convinced about the features or benefits offered by the brand originating from a particular country. Therefore, it can be argued that, similar to brand loyalty, consumers may also exhibit country loyalty. On the other hand, there is much research which has also focused on the relationship between patriotism and brand loyalty (Lee 2005, Karjaluoto et al. 2005) and in that they argued that customers from a particular country usually tend to favor products which originated from their home country. In short based on the above discussion, it can be considered that customers from different national cultural background exhibit different brand loyalty (Nwokah, 2009, p. 21). Thus, it is hypothesized that there is a relationship between the national cultural background and brand loyalty.

### **2.3 Perceived Brand Quality and National Culture**

According to Aaker (1991, p. 85) perceived quality is defined as the "customer's perception of the overall quality or superiority of a product or service with respect to its intended purpose relative to alternatives". Malai and Speece (2005) assert that culture has a direct effect on how people perceive things. Based on this perception, people tend to qualify a product or brand by synchronizing their choice with that of national celebrities, family members, friends and peer groups etc. Quality is not measured specifically in terms of performance but largely based on what society and culture 'defines' as quality.

It is very common to note that if all peers use a similar brand of mobile phone the new-comer, despite having a different preference, will be influenced by his peers and sooner or later would intend buying the same brand. This is because of the perceived quality he attaches with the particular brand which comes from the word of mouth of his peers making it a status symbol. Similarly, in larger context, the national culture influences the preference of a certain brand over the other, though not entirely, and make certain brand/s preferable than others.

## **3. RESEARCH METHODOLOGY**

This section is devoted to examine the methodology which has been used in this research. That is, it offers a framework about how the research project has been performed in its entirety. Therefore, this section is to

define the various methods used to gain primary and secondary data and to explain and discuss why one method has been selected rather than another.

### 3.1 THE RESEARCH DESIGN AND SAMPLING PROCESS

For the purpose of this study, the targeted population comprised of students of Umeå University who currently possessed a mobile phone. In quantitative marketing research, it is very unlikely that a researcher will be able to survey every person in the target market within the given time frame; as a result, a sample is usually drawn. Thus, a sample size of 150 respondents was deemed to be appropriate. For this study, the sample was selected by using a *stratified random sampling*.

Based on the “Contact List” received which included a list of 233 students from the different faculties and from different study levels, a proportional allocation was done based on their educational level. Overall, the potential respondents comprised of 74 Bachelors, 66 Masters and 10 PhD students in our sample size of 150 respondents. An Email survey was then sent to this target sample. However, to ensure a high respondent rate, reminder emails were sent each day after the first email emphasizing the importance of our study. Out of the 150 questionnaires allocated, all of them were correctly filled giving a response rate of 100 per cent.

## 4. ANALYSIS & DISCUSSION

In this section the result of the questionnaire survey will be presented. It will provide findings of the background variable (education level) and will test the proposed hypothesis.

### 4.1 Descriptive Analysis

The descriptive analysis aims to quantitatively summarize the profile of the students and general information about the brand of mobiles they are currently using or have used before.

Respondents were grouped from different nations from Europe, Asia and Africa based on their particular regions. The statistics show that 90, 40 and 20 respondents belong to Europe, Asia and Africa respectively. The difference in numbers is because majority of students at Umeå University are from Europe, few from Asia and very less from Africa.

From the respondents is able to figure out that Sony, Samsung and Apple is popular in European, Samsung and Motorola to African and Nokia, Samsung and Apple to Asian countries. The mode was used as a measure of central tendency to check how many respondents use same brand in a particular region to come up with the data figured above.

### 4.2 Inferential Analysis

In order to test the different hypotheses, an inferential analysis was conducted. Basically, in this case it will be used to investigate any association between the two different sets of observations using a chi-square test of association.

SPSS was used to find the P-value and it is based on the following assumptions:

- If the probability value  $p$  computed by the Chi-Square test is very small, differences between actual and expected values are judged to be significant (large) and therefore the author will conclude that the assumption of independence is invalid and *there must be a relation* between the variables.
- If the probability value  $p$  computed by the Chi-Square test is large, differences between actual and expected values are not significant (small) and the author will not reject the assumption of independence, i.e. it is likely that the *variables are indeed independent*.

**H<sub>1</sub>:** *There is a relationship between the national cultural background and brand loyalty.*

To test the first hypothesis a chi-square test was conducted. As depicted in the table below the **p value** is greater than 0.05, thus in this case, it can be concluded that there is no relationship between national cultural background and brand loyalty.

**Chi-Square Tests**

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)
Pearson Chi-Square	.806 <sup>a</sup>	4	.938	1.000
Likelihood Ratio	1.330	4	.856	.969
Fisher's Exact Test	.938			1.000
N of Valid Cases	150			

Table 2: Chi-square tests to analyze the relationship between national cultural background and brand loyalty.

**H<sub>2</sub>:** *There is a relationship between national cultural background and perceived brand quality.*

To test the second hypothesis which seeks to analyze if there is any relationship between national cultural background and perceived brand quality, a chi-square test was used again. As depicted in the table below, the p value is greater than 0.05, thus it can be inferred that there is no relationship between those two variables.

**Chi-Square Tests**

	Value	df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)
Pearson Chi-Square	1.792 <sup>a</sup>	4	.774	.886
Likelihood Ratio	1.900	4	.754	.942
Fisher's Exact Test	2.086			.805
N of Valid Cases	150			

a. 5 cells (55.6%) have expected count less than 5. The minimum expected count is .36.

Table 2: Chi-square test to analyze the relationship between national cultural backgrounds and perceived brand quality.

## 5. CONCLUSION

Based on the analysis of data gathered from questionnaire survey, the proposed hypothesis was proved wrong, whereas, the null hypothesis which states that there is no relationship between national cultural background and two dimensions of brand equity holds true. There could be certain reasons for this as it contradicts the prevailing theories from which the author derived the hypothesis. One of the main reasons could be that the authors considered the national culture as a whole while ignoring within-national cultural differences.

This means that individuals within one culture may differ from that of others and hold different and unique values towards certain brand quality or loyalty based on their own cognition and personal experienced. So this implies that the respondents from one national culture do not perceive the quality of a certain brand likewise, rather, they have their own individual preference and choice which is different from others. As so, the companies should focus on different cultures within culture while developing marketing and entry market. One of the major limitations of this study is the approach used to study the subject matter. For this study, a quantitative type of structured questionnaire was used which involved simply responding to

preconceived categories. This as such did not allow the respondents to freely and openly express their views. Additionally, only two dimensions of brand equity were considered which provided a narrow focus of the subject.

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## INNOVATIVE CITIZENS IN AN INNOVATIVE SOCIETY

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### ABSTRACT

Nowadays critical and transition economies set new boundaries meanwhile extend new solutions. Among the soft and plastic circumstances one should construct his/her own preferences regarding values and the walk of life. As the coins have two sides, some values are incompatible with another, like tolerance and patience can't manifest at the same time; when we want to perform well – or as the business attitude requires it. Another example is the paradox of the technical development and the cautious consumption of the natural heritage – an order must be taken in an ethical way – but how?

The *grounded theory* (Glaser & Strauss, 1967) says to let the researcher lead him/herself through his/her observation, like finding solutions without creating strict hypothesis at first. The wide angle saves the scholar from missing the core questions of the analyzed area. Babbie (2003) goes deeper and encourages researchers to realize themselves in using unusual data sources. The latest research methodology trends accept the *mixed method research design* (Teddlie & Tashakkory, 2003), which emphasizes strengthening the results by using variable techniques for one topic: they suggest verifying the theory through more methods, like every road shall take us to Rome. They say each topic shall have its own framework. The author is conducting her research in this open intellect, so she developed its own hybrid design, and this paper contains the main results of the first phase.

The nature of open innovation is quite unusual. The traditional business practice was to keep secrets, all the information and brand-new concepts among the dick walls of the HQs. Today the fast and transparent communication techniques revealed another possibility: open innovation. The creation of values and inventions can be made in a very cooperative way, reaching an extreme cost-efficiency and a win-win situation, which of course requires a new perception and know-how. The different situation and the different relations (regarding hierarchy and rank of importance) can be handled with different manners. Instead of profit maximization (in accordance with the satisfactory hypothesis) the ultimate goal is creating values. The question is how to manage the operational process? What is the criterion of appropriateness?

The following assumptions might give a guideline:

- The high level of social trust enhances the efficiency of the open innovation process.
- There is a link between the level of social trust and the financial status.

The demonstration of the pre-hypotheses went along with a quantitative survey with questionnaires. This research had 3 main focuses besides demographic details. As the followings:

- the better understanding of innovation, in an embedded context: I expected the placement of the term in the value system of the respondents. A couple of questions deal with the associations in connection with the innovation, the other requirement is to place the concept among other different independent values (independent from culture, location and civilization).
- There is a focus on a consumer and creator perspective with the help of attitude sentences, which contain the measurement of the willingness of acceptance and participation – like sharing information about it.
- The questions about the innovative industries and then then ranking of the industries was about to map the appearance of the innovation in the vertical chains.

The detailed explanations of the results of the above mentioned primary research can be read in this article.

### KEYWORDS

social trust, values, open innovation, mixed method research design

### JEL CLASSIFICATION CODES

M38, M39

## 1. INTRODUCTION

Drucker (1993) was the first, who linked innovation – as a change in value – , with business and marketing. He identified seven sources of innovation, three of them are exogenous (demographic change, change of views and the change of knowledge base); the rest of them is endogenous (the unexpected, the contradiction, the need of the process and the structural change of the industry or the market). This study focuses on the exogenous changes. Though all the segments are accurate and changing, it especially focuses on the changes in the views of the customers.

Then the literature has mentioned it in context of product development, or better said – according to Seybold's definition (2006), „Innovation is invention taken to market.” –, in context of launching new products onto the market. A basic innovation typology originates from Booz, Allen and Hamilton (1982). They introduced a grouping by using the criteria „newness”. Lately many researchers from different areas added their own classification (Henderson & Clark, 1990; Avlonitis, Papastathopoulou & Gounaris, 2001; Gatington, Tushman, Smith & Anderson, 2002; Lovelock & Writz, 2007; Harmancioglu, Droge & Calantone, 2009; Linton, 2009; Skare and Dosen, 2012). None of them defined the exact value that innovation contains. Csikszentmihályi's (2010) important remark regarding the topic: being simply different l'art pour l'art is not enough: the differentiation becomes more, when a value surplus takes the newness to a higher level.

The business literature recently introduced the concept of ‘coopetition’, which is considered the core competence of competitiveness (Ezealla-Harrison, 1995). The innovation networks develop from the value and aims to realize profit for their members. This optional, free cooperation is based on independent actors possessing diverse knowledge assets that can be used to generate new, innovative combinations (Amara and Landry, 2005; Crossan and Inkpen, 1995; Kogut and Zander, 1996; Miotti and Sachwald, 2003; Perks and Jeffery, 2006). Accordingly, such networks have traditionally incorporated R&D between complementary partners, such as suppliers and customers, pursuing cost cuts and better offerings. However, due to the faster pace and increasing cost of innovation, competing firms have also started to collaborate in terms of sharing the risks of R&D, standardizing their existing solutions, and bringing completely new ones onto the markets (Tether, 2002). This phenomenon, according to which competing firms cooperate with each other in order to create value and a bigger market for each participant, and then later compete for the created value, has been labelled “coopetition” (Brandenburger and Nalebuff, 1995, 1996). Competing firms have a long history of cooperation in many capital-intensive (e.g., manufacturing) sectors such as the automobile and aerospace industries, the aim being mainly to decrease the costs of production, distribution and marketing (Dussauge et al., 2000).

This mechanism is not satisfactory; its guarantees rely on the cooperative susceptibility of the societies. Fukuyama (1994) believes there is a proxy, which can help influencing the level of the social trust from the top-down approach. The expected benefit of the intervention is to enhance economic performance. Balamoune-Lutz (2011) proved that the social capital shows a relevant coherence to the, efficiency of the human capital, this explains why the quality and lifestyle of the society strongly influences the performance and the acceptance of the innovation. LaPorta and his research team (1998) found that the effect of trust on performance is quite convincing. They examined organizations, and the cooperation tendency between them. Their results show that by the 1% the enhancement of the trust level improves the efficiency of the legal apparatus, it decreases the level of corruption and helps keeping the rules of taxation. The relationship towards impersonal trust, education, health care, the development of infrastructure and the level of inflation also showed positive results. Other authors also strengthened their results (e.g.: Zak & Knack, 2001). None of them extended the examination to the observation of the link between social trust and innovation.

By now the usage of the word “innovation” dramatically increased in the media, which creates the illusion that innovation is a central concept of the daily routine. The evening news tells us about innovation,

- the cosmetic products (Nivea, Vichy, Rimmel, Schauma, Avon);
- various FMCG brands (Sure Women, Blend-a-med, Persil, Dylon, Oxi);
- the basic technology-intensive industries as automotive (Nissan, Mercedes-Benz C class, BMW, Citroen, Hyundai, Mitsubishi, Audi);
- IT and IT related industries (IBM, Mac, HTC, Fujitsu, Asus, 3M);
- even cities (Boston, Győr);
- furthermore public institutions (Colombus Hospital, San Diego State University)

use it frequently in their various ads (Youtube, web-page, TV spot, billboards, print ads)<sup>1</sup>.

The first consequence that the word 'innovation' is heavily overused which lead to the deprivation of the concept, furthermore, due to its unclear definition, its occasionally changing profile, the differences of interpretations it is not a classic value holder, and the intensified and wide-range media appearance just increases the confusion about it. The previous value concept from the marketing view emphasized the material values, like low price, quality (~what consumers get for the price they paid) (Zeitharne; 1988) at the early stage. According to the latest value research trends (Ulaga, 2011; Goel,2012; Fletcher, Melin & Gimeno,2012 Makienko & Bernard, 2012; Yoo & Bai,2012; Hollebeek, 2013) scholars and experts pay attention to the intangible and desired value terms of the individual. . They attain to reveal the latent value baselines, in regarding different views and perception thanks to different cultural backgrounds (de Moojing, 1998). Despite the value of money (see: Kenesei & Todd, 2003) some researches do not take prices as essential into account.

### **1.1. Goal of the analysis**

This study focuses of three main pillars:

- the better understanding of innovation, in an embedded context: the author expects the placement of the term in the value system of the respondents;
- the measurement of the willingness of acceptance and participation;
- questioning about the innovative industries and then then ranking of the industries.

## **2. THE WAY AND THE RESULTS OF THE RESEARCH**

The metaphysical approach might have some advantages for the science, also in a psychological sense it is even inseparable from human beings (Popper, 1977). Di Méo (1996, p 40-41) emphasizes the constant importance of the measurement of a current state regarding social structures, because his view is that these social structures are formed and strengthened by the social processes. This means that these subjective structures are not unchangeable, in the period of their existence they are constantly changing, up-dating themselves spatially and temporally according to the circumstances. This survey was taken after the establishment of the IT revolution, after the economic crisis. As Kissinger (1996) identified there are six leading superpowers, which can be considered as centers of a civilization. They are the USA, the EU, China, Japan, Russia and India. This survey took samples from Russia, which represents the orthodox civilization and from Belgium, which represents the western civilization.

### **2.1 Methodology**

After the international literature review and the brainstorming the author followed the Glaser and Strauss paradigm (1967): assumptions were set (see.: 1.1 Goal of the analysis). They form the theoretical framework of the customized research design. A quantitative empirical survey clarified the pre-hypothesis. By assembling the questionnaire the main criterion was the double check – the highlighted topics were asked in the questionnaire two times in different ways. Five-point scale questions were used, the benefits and the value holders were selected from the World Values Survey (WVS) list. In order to handle the low willingness to respond, the author intended to stick to the personnel questioning. The last list contained the industries of the European Commission Enterprise and Industry's collection. The expectation from the physical presence is a greater ratio of fully filled questionnaires.

As *Table 1* shows the samples were taken in the same volume during the fall semester of academic year 2012/13. The respondents were full-time university students specialized in economics and business sciences within the same age group in both cases. Due to their cognitive proximity and other similarities (see: demographical features) the samples are comparable. According to Huntington (1993) there are 9 separate

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<sup>1</sup> Author's collection (2013).

groups: Western civilization, Orthodox civilization, Confucianism, Islam, Buddhism, Latin-America, Black-Africa, Hinduism and Shintoism. The next analysis was about to compare the Western civilization, represented by Belgium and the Orthodox civilization, represented by Russia. The questionnaires were worked up in SPSS and Excel by using quantitative techniques. The research at this step didn't narrow its focus none of the Schumpeterian groups. Due to the composition of the sample the results are not comparable to previous studies.

*Table 1 Data of the survey (author's edition; 2013)*

Location	Time of the survey	Respondents	Language of the survey	Number of questionnaires		
				Planned	Filled	After data cleaning
Izhevsk State Technical University	2012.09.22 – 2012.10.06	Age: 18-25 Full-time students Future economists (marketing and trade, accounting, finance, international business...)	Russian	120	104	99
Brussels, École Pratique des Hautes Études Commerciales (EPHEC)	2012.11.05. – 2012.12.12.		English		101	99

## 2.1 Results

### 2.1.1. The better understanding of innovation

The respondents received 30 options, which could be considered as a value holder independent from location, culture and era. The first places are similar: it's firmly health and freedom; plus love. As Table 2 below shows there are differences in the two samples: the Russian respondents named fewer concepts and tend to choose emotional variables. Development is only on the fifth place. This is the only term on the top, and this is the only which refers to economic. In the Belgian sample the material value holders like well-being and power gained a bigger ground. The percentages are worth to observe: the significant majority can be seen in the Russian sample in each case, which refers to the respondents' commitment, while in the Belgian sample there are no striking differences – the rest of the value holders were appreciated mostly on the same level. The Russian respondents managed to reduce the rack a small, but unequivocal group. The Belgian students' opinions divided among each other. Their results show a less systematic pattern than the Russian participants' structure does.

Common is, that innovation is out of the top places. We found that innovation was ranked on the 13th place in the Russian sample, the 10th place in the Belgian among 30 value holders.

According to the results only in 10% of the cases is there a general agreement on independent value holders. Innovation is not representing a central value in none of the samples. The second classification clearly revealed the diverse positioning of innovation in respondent's minds from different civilizations. Due to the unclear definition it is not suitable for a beneficial core competence.

Innovation is separated from material attributes again in the Russian interpretation, while the Belgian respondents showed interest in innovation as a useful economic tool: they consider it as a mean of business. This confident usage is basically different from the cautious attitude of the other culture. The Belgian respondents handle the definition as it was tangible, while the Russian respondents have quite unfocused, an interdisciplinary-like approach.

On a global scale innovation has a changing place in the range of value holders. Referring to Kano's model (Kano 1984, In Nordhielm, 2005) product features can be differentiated. The threshold attributes are basic requirements; every product variant has these characteristics. E.g.: thinking about the cell phone it is sending SMS. The wider range and higher quality of performance attributes the product has, the more satisfied the consumer becomes. E.g.: the speed of the Internet. The excitement attributes are not expected, it often makes consumers surprise, and sheds a brighter light on the product. Following the logic of development if the features from the excitement attributes do not churn, they mostly get to the performance

attribute category. E.g.: the evolution of the size of the cell phones shows that by now it is an expectation to have a small and narrow device. The threshold category includes binary proxies, so if this category extends that involves a birth of a new product. E.g.: since we can surf on the Internet with our cell phones we call them smartphones.

In certain cases innovation is a must, an evidence (see: high-tech sectors) while there are some examples where innovation doesn't exist in the common sense, due to its place in the value chain or due to its position in the hierarchy of industries. The extended appearance enhances the dissonance in the consumer, and like the bull's eye tool showed at the end we get there, where our next washing machine is more innovative than intelligent ...Considering all the above mentioned suppositions the conventional usage of the word „innovation” shortly depreciate the term, causing loss of efficiency, importance and credibility regarding the whole innovation activity. The nature of innovation makes it hard to build a proper brand around the word, not just because the circumstances makes it hard, especially because it seems innovation is positioned on different stages of the benefit ladder; it represents both functional and emotional benefit, depending on the case.

*Table 2 Summarizing the results (author's edition; 2012)*

Question	Russia	Belgium	SUM
advantages in innovation	creativity safety activity success/ improvement business advantage/development	development moneymaking business advantage success improvement	business advantage improvement creativity moneymaking success
independent values	health freedom family love development	freedom/ health well-being knowledge helpfulness power	health freedom love knowledge/development happiness
innovation in the personal values' rank (30)	13.	10.	13.
influencing values- rank	knowledge future trust helpfulness relationship honesty fairness humility responsibility transparency	knowledge helpfulness humility trust responsibility relationship honesty future transparency fairness	knowledge trust future helpfulness relationship honesty humility responsibility fairness transparency

### 2.1.2. Questioning about the innovative industries

The last part analyzed the appearance of the perceived innovation on the industrial level. This dimension showed that some by nature, while other industries remain negligible in terms of innovativeness. The first task was that respondents had to decide whether a particular industry innovative or not. The group of industries is from the EU Enterprise list<sup>2</sup>. The second task – as a double check - asked the candidates to construct their on 5 level ranking via naming the most innovative industry to the less innovative industry. The benefit of the two-stage question is to receive a stronger result. In Table 3 can be seen that the answers in one hand are homogenous in one sample, but in another hand some minimal, but characteristic differences can be seen comparing the results of different civilizations. Due to the globalization the ‘international’ industries,

<sup>2</sup> See: [http://ec.europa.eu/enterprise/sectors/index\\_hu.htm#top](http://ec.europa.eu/enterprise/sectors/index_hu.htm#top)

like IT, computer technology and electronics are rocking, while the orthodox respondents tend to appreciate manufacturing industries in a higher rate, while the composition of the western sample is much diverse: industries from a wider spectrum can be found on both lists.

Interesting – and common, that the less innovative industries were cosmetics, FMCG production, leisure, entertainment and clothing in both cases. From the end-consumers aspect we assume that they meet more innovative products during the daily routine, however, these ‘innovations’ are not appreciated or for some reason the respondents did not link the tangible and accessible innovations to certain industries. Unfortunately the quantitative survey is not suitable to properly answer such dilemmas.

*Table 3 Innovative industries evaluation and ranking (Source: author’s edition,2012)*

Question		Russia	Belgium	SUM
Evaluated as innovative – rank on a quantitative base due to a binary question		IT computer technology biotechnology automotive aerospace electronics advertising telecommunications education transportation sports investment banking energy health care	IT electronics energy biotechnology aerospace health care computer technology aircraft telecommunications automotive advertising software chemicals logistics	IT computer technology biotechnology electronics aerospace automotive telecommunications advertising energy health care aircraft logistics transportation electronics
Evaluated as innovative – rank on an opinion base (rankings of the individuals)	1	biotechnology IT aerospace	computer technology electronics	IT technology computer
	2	biotechnology aerospace computer	energy computer electronics	biotechnology electronics Computer
	3	computer IT electronics	aerospace biotechnology IT	IT computer electronics
	4	software electronics biotechnology	aircraft IT aerospace	IT electronics aircraft
	5	IT computer automotive	IT automotive electronics	IT computers automotive

Industries from the lower part of the sectors (agriculture, industry and services) in a vertical view are not believably match to the innovation, because of cognitive dissonance. At the other end of the scale the issue is the same: there are industries (such bio – or nanotechnology), where innovation is a must, a basic requirement, this is why it can’t be a strong differentiator. The results suggest that due to the low ranking especially in the case of FMCG it is hard make innovativeness work, because it isn’t linked in consumers’ minds, which makes its usage in marketing communication questionable. Furthermore, not a relevant number of consumers have enough technical knowledge (De Luca, Atuahne-Gima, 2007), especially regarding breadth and depth (Zahra, Ireland & Hitt, 2000).

### 3. CONCLUSION

In terms of the topic as Hooley – et. al (2000) reckons the relationships between market orientation, strategy and performance follow predictions: the business orientations may coexist with a market orientation creating a richer and more complex set of drivers, particularly utilizing consumer ideas' power. The problem is that the practice of the consumer idea pooling hasn't reached the critical mass of the enterprises to adapt it as a daily routine. Indirectly Verhoef & Leeftang (2009) strengthened this view, when they identified the marketing department's greatest disadvantage: the lack of ability to renewal. In order to dispel this myth another interesting research could advise smart techniques hidden in the diffusion of the open attitude from the consumers' side. As Krotov, Kouchtch & Smirnova (2008) emphasized the marketing aspect in the relationship management in the supply chain, the author extends their conclusion to the customer relationship management, especially the direct or indirect consumer involvement in value creation processes, as a cost-effective source of innovation (Podmetina, Vaatanen, Torkkeli, & Smirnova,(2011) also referred to it.).

In terms of this research the first level functioned as a funnel, while on the second stage a modified questionnaire will be used. The survey will be repeated in the same geographic areas (Western and Orthodox civilization). The enhanced number of data shall strengthen the pre-assumptions and operate as a steady base for a proper comparison. Parallel a qualitative research would be worthy to conduct in order to gain a better understanding of opinions regarding the innovativeness of an industry. This multi-level research technique enabled the author to reduce later the content of the assumptions transforming them into well-defined hypothesis.

### ACKNOWLEDGEMENT

This paper is dedicated to my beloved brother, Benjamin, in order to inspire him to keep moving forward, as he has been doing so with hard work since his childhood.

Hereby I would like to thank all the support, trust and inspiration for my supervisor and professional role model, Prof. Dr. Józsa, László.

I am deeply indebted to the head of the Doctoral School of Regional and Economies, to Prof. Dr. Rechnitzer, János, who took the time to track the development of the research step-by-step from the beginnings.

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## **INTERACTION BETWEEN HIGHER EDUCATION AND INDUSTRY IN REGIONAL ASPECTS**

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### **ABSTRACT**

The development in the information technology and in the telecommunications, weltered in the 20th century, had basically changed the economic and social relations in the world of globalization. Today the knowledge has already meant the economic and political centers, the base of the society is the knowledge society, and the direction of the capital investments is the knowledge capital. The most important institutions of the society based on knowledge have become the institutions dealing with production, distribution and reproduction of knowledge. Nowadays this role is occupied constantly by the educational institutes, especially the higher education. Currently the role and the function of the higher education institutes reevaluate the world and as a result a new aspect of economic and social roles and functions has appeared.

These impacts are felt in Hungary too, where recently demographical changes and reforms in the higher education change the state of the educational system. Nowadays higher education is a key strategic resource in the globalized and knowledge-driven economy for achieving economic success. Moreover a higher education institution can only be successful if it becomes at the same time local, regional and national actor of the economy. The Hungarian higher education system is being reorganized from 1989, at the end of the communist regime, which has many structural and financial problems. The main failure of the last twenty years governance that the higher educational politics has not been connected to the regional development politics. But some positive example proves how a university can play an important role in the regional development.

Győr is one of the most quickly developing city in Hungary, where Széchenyi István University plays a vital role. The University is actively engaged with its own region. The presence of the world's largest engine plant, the Audi – which is a global company at the premium segment – and the concentration of the automotive industry in the region create new kind of opportunities and expectations for the City and the University. Recently the foundation stone of the new factory resulted Győr has become a vehicle factory with the whole vertical processes of car manufacturing, which also means new challenges. The major quality-industry, Győr, the University's collaborative, joint development directions is a possibility in which the knowledge and the roles have important meaning for success. It could contribute to the regional development, and could ensure stable and predictable operation for the University.

### **KEYWORDS**

Regional development, higher education, knowledge-driven economy

### **JEL CLASSIFICATION CODES**

L32, L39

## **1. INTRODUCTION**

The role and the importance of higher education are re-evaluated nowadays. During the past twenty years the development of informatics and telecommunication technology has induced economic and social changes in the world as a result of which the labor market demands of the formed knowledge-based economy and society have been changed drastically. At the same time the nature of knowledge and its economic-social role have also changed. All these require an absolutely different type of higher education.

What's more in Hungary education has had a special development path during the past twenty years. The post-socialist development, the expansion of higher education and the education infrastructure brought about

by this expansion and the decline of the number of youngsters in the declining society characterized by a narrowing age structure have created serious challenges for the institutions by nowadays.

Consequently in the present situation the institutions have to compete with each other to gain more students, state funds and maintenance, the development funds of the EU and the corporate R&D commissions. In this situation the conscious strategic planning, the correct use of marketing and management means and the better adaptation to the rapidly changing market conditions can be the key so that the institutions could maintain.

For this a change of attitude is essential according to which not only the institutions themselves have to be analyzed but the institutions as the integrated parts of their environment as well. In the changing situation the key to success can be how the institutions can form tight economic and social relations with their own cities and regions, which relations can develop the given region's economy and doing so they can also create directly or indirectly numerous advantages for the higher education institution itself.

The main failure of the last twenty years governance, that the higher educational politic has not been connected to the regional development politic. But there is some positive example, how can play a University an important role in the regional development. Győr is one of the most quickly developing cities in Hungary. Széchenyi István University at Győr plays a very important role. The University is actively engaging with its own region. The presence of world's largest engine plant, the Audi – which is a global company at the premium segment – and the concentration of the automotive industry in the region create new kind of opportunities and expectations for the City and the University. Recently the foundation stone of the new factory resulted Győr become a vehicle factory with the whole vertical processes of car manufacturing, and it means new challenges too. The major quality-industry, Győr, the University's collaborative, joint development directions is a possibility in which the knowledge and the roles have important meaning for success. It could contribute to the regional development, and could ensure stable and predictable operation for the University.

As a PhD student of Széchenyi István University in this paper I study how the regional embeddedness of a higher education institution can help the success of the institution in the fierce competition; and I analyze all of this with the help of an example of the alma mater.

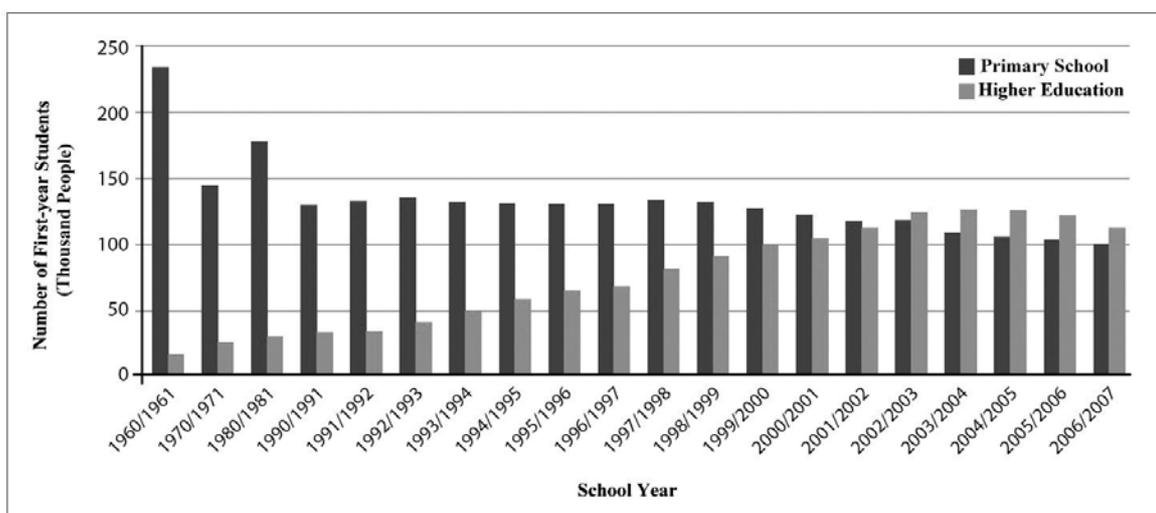
## **2. THE HUNGARIAN HIGHER EDUCATION SYSTEM**

According to the census held in 1990, in Hungary only 10 % of the population under 25 gained an advanced level qualification that was much lower than the North and West-European practice. That was the reason for the remarkable quantitative development of the Hungarian higher education in the '90s. The base of this action was partly the high rate of those born in the mid '70s, who took their final exam in the '90s. However, because of the demographic change, this growing tendency turned round, 1999 was the peak year, considering the passed final exams, and since then this number has been continually decreasing (Katona, 2006). On the other hand, besides the growing number of students who take part in secondary education, there was a growth in the rate of secondary school students who would have liked to study on after final exam. Nevertheless, this rate cannot grow arbitrarily, in the West-European countries it was 50% at the most, and by the millennium the Hungarian average had come up with the European one. In the first years of this boost, typically among the full-time first grade students there was a lot who took their final exam not exactly in the previous year, but earlier. So due to the lower entrance rates of the previous terms and the expansion of the entrance frame numbers, a significant part of the students who could not continue their studies right after their final exam could gain a place at a higher education institute. This reserve had exploited by the mid '90s (Katona, 2006). At the beginning of the '90s the number of students who had been studying at correspondence courses started to grow quickly, which was attributed to similar causes mentioned above. Those, who previously could not get into colleges or universities but their lifestyles did not allow them to continue their studies at full-time courses, they chose correspondence education. In the recent years the headcount of this group has started to decline as well, because who wanted to study on, could do so earlier. Currently, rather second degree educations offer a base for the correspondence courses.

All in all, we could say that the reserves of the headcount of higher education have exploited after the millennium. On one hand, the demographic boost has slowed down; moreover, the number of the youngsters shows a well-known declining tendency, which is demonstrated by Figure 1. On the other hand, the other

reserves have depleted as well; the rate of secondary education students who study on could not be boosted any longer, only if we develop secondary education. And the number of those who continued their studies as an adult because earlier they did not have the chance to do so as a result of the tight frame numbers has decreased as well. What's more, similar to more West-European countries, demographic forecasts are unfavourable. It is well-known that at the time of the millennium, quasi half of the students who had applied to a higher education institute could get into one of the institutions. In 2000, this rate was more than two thirds. Furthermore, in 2008, the entrance method excluded the quality selection from the system because 96% of the applicants could enter one of the institutions – so with a solid exaggeration it can be said that who had applied was admitted as well.

Figure 1. The number of first-year students in elementary schools and in higher education annual breakdown (Source: Lannert, J. 2008)



The reason for this was the plan to introduce tuition fee (development contribution) and the introduction of the prep language education as well. Among other things, that's why in 2009 there were approximately 30% more applicants for higher education than in the previous year. In 2010 the number of those who took entrance exams did not change considerably. Public higher education institutions get the funds needed for their operation from the central government budget so they are financed by the whole society through the state redistribution.

What's more the institutions can have own incomes as well, which can link to their operation, but the institutions can engage in additional activities too (e.g. research and development, services), and last but not least they can also use tender funds. In Hungary the demographic status of the country has created a very hard competition at higher education. Figure 1 shows the tendencies of the decreasing number of primary school and higher education students. As a result of the Quantitative development in higher education started in 1990, the number of students increased from 108 thousand to 424 thousand, and reached a peak in the 2004/2005 academic year. Since then the number of students has declined steadily, and the number of young people shows that this process will continue. In 2016 the number of those under 18 will be 15% fewer than in 2000 (Lannert 2008). The Hungarian higher education has to meet both the challenges of internal demographic situation and the external competition in the European Higher Education Area at the same time. It has to do all this to be able to adapt the changing needs of labour market and the new types of market demands of knowledge-based economy at the same time. The situation is improved by the impact of the world economic crisis too.

According to the data of the Ministry of National Resources, at present, there are 70 higher education institutions in Hungary, from which 19 are state universities, 7 are non-state universities, 10 are state colleges and 34 are non-state colleges (NEFMI, 2011). The non-state institutions run as church institution or run by foundations. The institutions are separate economic organizations in the sense that within certain legal frames they can use their diverse incomes autonomously to finance their operation. With the higher education law which was put into force in 1993 the finance of the governmental institutions on normative grounds was introduced (Polónyi, 2002). The main source of income of higher education institutions is the quota grounded

on their performance, which they still get after the number of their students. This clearly depends on the headcount of the students. However, the main expenditures of the institutions do not depend on the number of the students, because the maintenance and the actuation of the buildings, the acquisition of the lab accessories and the educational assistances, and moreover the number of the lecturers result fixed costs either in midterms as well. Therefore the fluctuation in the number of students or rather some classes with smaller head numbers can easily cause financial problems in the given higher education institution. Therefore the institutions are interested in exploiting their extant capacities as much as possible or sometimes beyond this border. For this purpose the most higher education institutions adapt marketing tools as well (e.g. image building, PR activity and advertisements).

The biggest disadvantage of this system is that its interest is to let more and more students get into the higher education and to keep them as well and as a consequence this, the system is not optimized in accordance with the level of social utility. Due to political reasons the governments do not tackle the sorting out of higher education institutions and the places offered by them, even though they are aware of the decreasing number of youngsters therefore the mass education will turn to over education that will lead to the destruction of its quality. Besides that this system costs too much for the government – and consequently for all of the tax payers irrespectively of their level of education – it does not even operate with an eligible efficiency. Structural disproportions manifest in the education, as in contrast to the claims of the labour market, those qualifications dominate that are demanded by the applicants. The frame numbers of education are not divided accordingly.

### **3. CONNECTION BETWEEN HIGHER EDUCATION AND REGIONAL DEVELOPMENT**

The development in the information and the telecommunication technology took place in the 20th century basically changed the economic and social relations in the world of globalization. While in the middle ages the huge agricultural estates were the economic and political centers, the base of the society was the agricultural society, and the direction of the capital investments was the agrarian sector, in the modern history the economic and political centers were the industrial ones, the industrial society became the base of the society and as for the capital investments, the industrial capital became the main direction. In the history of nowadays, which is also called as the newest history, the knowledge centers are the economic and political centers, the base of the society is the knowledge society, and the direction of the capital investments is the knowledge capital. The institutions dealing with the production, the distribution and the reproduction of knowledge became the most important institutions of the knowledge-based society (Bana et al. 2007). Nowadays this role is increasingly occupied by the education institutes, among them the higher education. The role and the function of higher education institutes have been revaluated worldwide nowadays and consequently a new aspect of economic and social roles and functions have appeared.

In the age of our economy there is a growing significance of the interaction of the society, the universities and the industry. The society based on knowledge is the condition of all transfer of knowledge on an individual and an organizational level. We live in a network-oriented society, where the development depends on primarily ability to cooperate. Earlier the condition of development were the more and more specialized research and education, therefore we should penetrate deeper and deeper into the certain fields of science. Instead of this, today the expansion of contacts, the communication and the cooperation are more important and through the chances reside in them; the approach of a given problem can be done from different point of views and competencies. All of this follow from the change of the technological and the social paradigms: till earlier a given product and the technology used for its production were in the focus, today the theories, the conceptions, the ideas and the solutions are the main parameters (Rámháp, 2011a).

There is a growing significance of interdisciplinary, because in our days one can be an expert of his or her field or occupation in vain, he or she can only reach a really quick development when he or she has an overview of other fields of science or has the capability of cooperating. This challenge exists not only in the business sector, but among university students as well. The preparation of students for the multidisciplinary work is important through different researches and teamwork opportunities. The significance of intercultural challenges has appreciated. However, to establish conferences and researches which exceed the borders of nations, it is important to have a common language that everybody knows. Today it is the English in most

cases. But beyond the common language, there are other obstacles of intercultural work, such as cultural and other problems.

The changes happening in the society and the economy have serious consequences on higher education as well and they convert the relation of the certain institutions and their region. It is hard to find a solution for the problems of the globalized, strongly competitive and knowledge-driven economy without convergence. A more differential politics can result development which leads to essential changes in the conventional functions of the state and through workforce it boosts the spread of networks. Only more flexible and more adaptive new institutional structures are able to bring together the different interests. These could be the answers to such complex and multidimensional social problems like regional development. Supported by the politics of the EU, the partnership of the social and the private sector has been becoming the common speciality of the regional level in many European countries (OECD, 2007). The conception of social capital should be built in the governance to make community actions more effective. This can be identified as the main factor of a successful region, and it can boost the development of the ability of political institutions to solve problems. Regions need properly qualified workforce to mobilize and exploit their sources, boost the growth, develop their competitiveness and keep their extant investments. The regional participants contribute in different ways to the non-financial advantages of the region; the collective work in turn helps to develop the regional knowledge, the abilities, the culture and the institutional consistence. Universities play a central role in the reproduction and adaptation of human workforce and in the production of social capital so they have a growing significance among the regional participants.

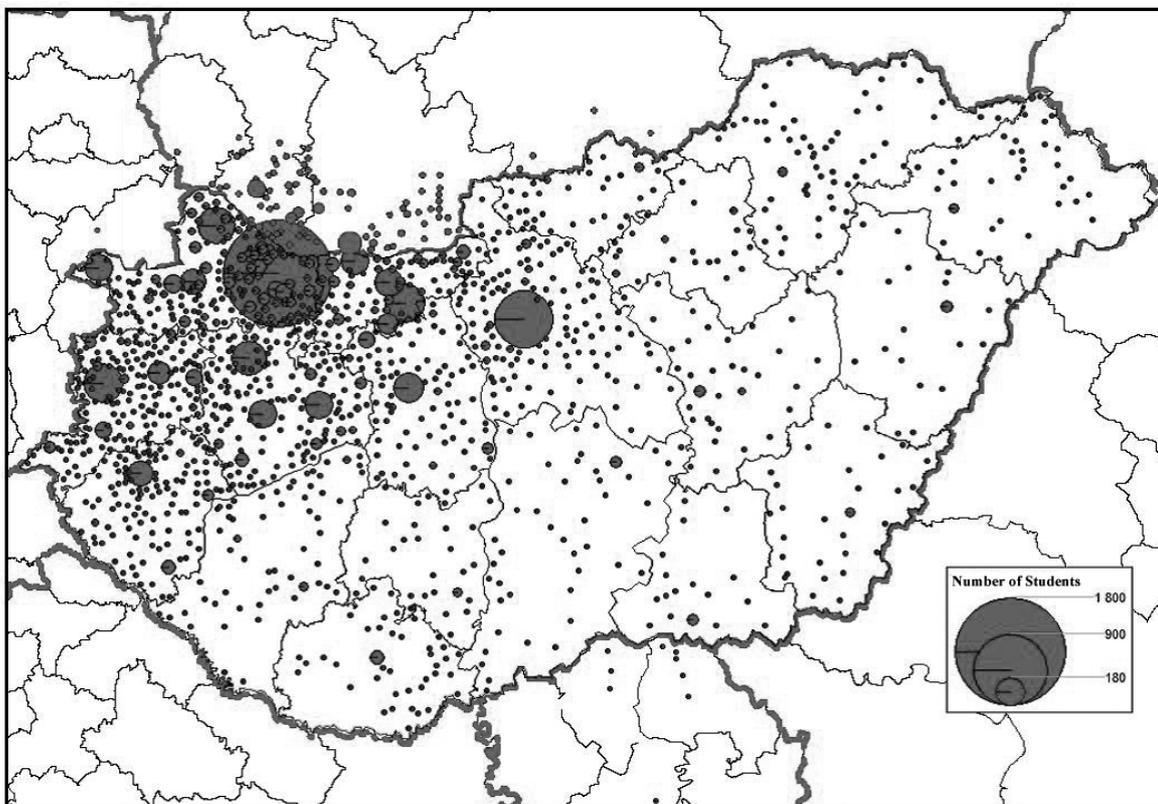
The role of higher education institutions is acknowledged considering the supporting of regional governance (Hudson, 2006). In the knowledge-economy education is a main strategic source through human capital to gain economic success. So the pressure on the regions has been continuously growing to become studying, knowledge producing communities which focus on the constant development, the production of new ideas, corporate learning and the transfer of knowledge, and doing so supporting regional development and welfare. This entire means that a more prominent role should be attributed to universities as the centers of knowledge in strengthening economic growth not only at a national but also at a regional level. The claims have shifted towards exploitable knowledge and its dissemination.

#### **4. SZÉCHENYI ISTVÁN UNIVERSITY**

Széchenyi István University is the dominant institute of the region of Győr. Regarding the foundation of the Technical College of Transport and Telecommunication which was the predecessor in title of this institute; a decision was made in 1963. This college began to operate in 1974. Since 1986 this institute has been named after István Széchenyi and it has got a university grade since 1st of January 2002 (Széchenyi István University, 2005). At the moment there are qualifications on 3 faculties (technical, economic studies and law faculties) and on 2 separate institutions (musician arts and health studies). In 2004 the Multidisciplinary Social Studies and in 2005 the Multidisciplinary Technical PhD Schools were accredited and right after that, these schools began to operate (Széchenyi István University, 2011a). Today this institution has already had more than 40 accredited qualifications and the number of its students exceeds 10 000.

In the mission of the institute from the beginning there is a consciousness of regionalism because the institute itself is inspired to serve the niche in the qualification of the region. Accordingly the main aspiration of this institute is to become such a center of knowledge which can serve its region with its supply of qualification, research and development - and through this the country as well (Rámháp, 2011b). The institute's development plan which is in force at present says that „the mission of the university is determined by the claim of the economy and the citizenship of the town today and in the future as well to offer studying facilities in more and more faculties, technical fields and qualification levels for more and more youngsters living in Győr and around Győr by sufficing the claim of the region's human resource to build a society which is competitive and is able to renew”. This target is reflected in the present operation of the university as well. It can be clearly seen in figure 2. that the locality of this institution spreads to all of the country, but most of the students come from that part of the “Dunántúl” (Transdanubia) which is on the North from Lake Balaton. This almost covers the NUTS2 planning and statistic regions of the “Nyugat-Dunántúl” (West-Transdanubia) and the “Közép Dunántúl” (Mid-Danubia).

Figure 2. The admitted students of Széchenyi István University, breakdown by place of residence (Source: Tamándl, L. 2011a)



In this area we can find those areas of the country which are the most developed ones considering economic and social life. If we don't take into consideration the capital and the Mid-Hungarian region, the economy is the strongest here in Hungary. Among others the largest vehicle production center of the country can be found in Győr in which center we can find the Audi factory, the main producer of our country. The regional role of higher education institutes can be active or passive. While the traditional big universities have more than 30.000 students which represent a significant economic potential on their own environment as well; state contributions spent on higher education and the spending of the students who were attracted from other areas will boost the economy of the given area. This also contributes to the regional development but it only means a passive role. In contrast Széchenyi István University has to shoulder an active regional role. The basic condition of this is the creation of regional embedment and regional partnership. Since 1990 the expansion of higher education has begun and it has gone hand in hand with the growing number of institutions parallel to the growing number of students. To equalize the regional differences the government supported the establishment of new institutions and new qualifications as the tool of regional development policy. This however meant an economic policy which was ruled from above, and its target was some kind of redistribution to equalize the regional disparities.

The biggest problem was that this method did not take the local and the regional claims appropriately into consideration. With the decreasing number of youngsters most forms of qualification which was launched at that time, today are in a difficult situation and there were some that had to integrate into another bigger institute. In contrast the target of regional policy cannot be the redistribution among regions and the equalization of developmental disparities but to foster the self-development of regions in which higher education has an important role. The existence of higher education institutes is tightly related to regional development and their absence could contribute to the decline of a given region. In appropriate circumstances higher education institutions can have an advantageous effect on regional migration because they foster the entrance of the youngsters into higher education and the highly qualified workforce with degree can have a

positive effect on the employment and contributes to the shaping of other advantageous specialities such as the widening of the cultural climate and the creation of more attractive living conditions in the region. Through knowledge and expertise higher education institutes facilitate the creation and mobilization of the most important resources.

**The strategy of success – Active regional roles:**

- Higher education institutions are able to suit their qualification programs, the orientation of their researches to the claims of the region and with it to the direct demand. The result of this tighter cooperation will be seen in the added value which does not only bring profit for the higher education institute but for other regional performers as well. However we should not forget about that the different types of higher education institutes fill different positions in the national and regional education system therefore they get into other interactions with the local and regional communities. A good example of this is the Széchenyi István University which suited its whole qualification palette to the workforce claims of the region. The establishment of the predecessor in title of Széchenyi István University was forced by local economic and labour market claims in the '70s and this process strengthened the enlargement of the qualification palette and played a big role when the institution became a university in 2002 (Kovács, 2011). The advantages connected to the embedment – see it below - were summed up on a conference by the deputy of the rector. The embedment into the regional/local sphere means a chance for the higher education institution which is worth exploiting:
- The local sphere (local governments, local politics) has a growing sensibility to higher education
- Local governments dispose minimal resources of support but once a while they are givers (for example buildings, parcels, common investments)
- The local/regional economy appears with changeable intensity to be a research or educational procurer; the market has not evolved and institutionalized yet but there are some progressive signs (Regional Centre of Knowledge, Centre of Cooperation Research, for example Audi clusters, institutional relations)
- The local society is proud of its higher education, the huge number of graduates is an important element of marketing but it has not been a Maecenas and a supporter yet as the forms of this is shaping now, and communicational institutions (charities, senior student organizations)
- The effect on the local economy has not evinced yet, but it can be significant on the housing market, the commerce, the hospitality and the cultural consumption; tourism (for example conference tourism) it is not perceived; volatility in the behaviour of students (for example: travelling home)
- The embedment into the regional development is weak, occasional, it appears in the developmental conceptions but not with a huge weight, the participation is low
- The contact of the higher education policy, the local policy and the science policy is unambiguous and not clear (there are only signs but the results are missing) (Rechnitzer, 2011)

The basic condition of regional embedment is regional partnership. This means that all of the regional performers cooperate with other performers in favour of the development of the region. In this the university has a significant role through the partnership with the local governments, the local enterprises and the inhabitants. I will introduce the role of Széchenyi István University according to this.

**Cooperation with industrial actors – The possible level of connection between higher education institutes and the industry:**

1. Connection between products, services and results: The advantage of the common activity comes from the combination of the services of the company and the educational and research activity of the university. A typical example of this when the university is the subcontractor or strategic partner of a company which transports products or services to a third partner (eventual consumer)
2. Connection between resources: In this case the partners see it as an opportunity to share employees, resources and financing in the frames of an R&D project. The university gets financial support for the R&D from the company who enjoy the results of this
3. Connection between products and services: This can happen when the members of a company extend their qualification through lifelong learning at the university and the university invites the employees of the company to become part-time lecturers. (Hansen et al. 2009)

Széchenyi István University cooperates with several small and big companies operating in the region and all of the levels mentioned above are present in the relations. From the several companies AUDI HUNGARIA MOTOR Ltd. emerges as it is a significant company both in the area and in the country. Since

the autumn semester of 2008 the professorship named after the Audi has been operating. From the foundation of this both partners will gain profit in the long run. The university hopes that the engineers graduated here will get - build upon the know-how of the big company of Ingolstadt- such a qualification with which they become attractive on the labour market. In turn the Audi hopes that it can enlarge its circle of employees with excellently qualified experts; thereby strengthening further the position of its premise in Győr which is now the largest motor factory in the world.

The dual higher education system represents how the industry and higher education can efficient co-operate. In this case the economic actors also take part in the education of students. Széchenyi István University is charged with several R+D projects by the neighbouring concerns. The aims of these projects are the following:

- makes opportunity to effectively take advantage of the human resources and infrastructure that already existing in the higher education institute
- provides additional payment for employees
- gives current and professional questions for the university lecturers and researchers
- gives opportunity for student to gain experience in industrial projects that are similar to the real industrial projects

For this such a management structure is necessary that

- secures the possibility to non-business operation and in these projects experienced and practical experts can be flexibly employed
- gives opportunity for participation of lecturers and students
- facilitates the transaction of the procurement, that necessary for the projects, and connecting payments without the public institutional nature of the university, for instance there is no need for public procurement process

Thus the actors of the two parts, the higher education and economy, can take advantage of the cohesive effects that originate from cooperation. These two parts can learn from each other, therefore the innovation and competitiveness may increase that also has a positive effect on the productivity and employment. These aims are laid down in EU 2020 Strategy and have emphasized role in the New Széchenyi Plan (national development strategy).

Széchenyi István University has co-operated with Audi Hungaria Motor Ltd. that is a dominant vehicle industrial concern in the neighbourhood and the country's largest concern. However the projects and qualifications also cover other vehicle industrial actors. In the course of the project new cooperative organizational structures has been devised. These can be a model for other higher educational institutes in order to co-operate the neighbouring actors.

## 5. CONCLUSION

As we could see, higher education is facing several new challenges worldwide. The claims against knowledge, the institutions and their students and teachers are changing. We should suffocate the claims of another type of society and economy in another way. Moreover, the Hungarian higher education faces further challenges as well. The Hungarian institutions get into a serious competition situation because of the decreasing number of youngsters, the present system of institution financing and the bad institutional structure. For the countryside institutions it is hard to meet the requirements of this competition. Széchenyi István University as a young institution has to meet the expectations of this competitive market. Its creation, qualifications and operation is different from the conventional Hungarian higher education institutes. This shows a new type of way in the strategy of the institute. The key of the subsistence can only be if the institute cooperates with other performers of the area and takes part actively in the further boost of the region. The appropriate qualified workforce, the R&D potential and the well-directed developments help the enterprises' settling down, the creation of new companies and the boost of local industry and economy. This creates more workplaces in this area. The well-shaped qualification structure ensures a workplace for the students graduated at the university in the region, which can make Széchenyi István University attractive to them. We could see that the inhabitants of the region and the number of local secondary schools can mean new supplies for this institution. A more effective cooperation with the local governments and the budgetary organizations will bring to the institute a bigger scale of developmental opportunities. Besides the offered education which

is better than its competitors' ones and the better marketing communication, regional embeddedness and regional partnership can be the main elements of the successful strategy. It can help higher education institutions to be successful in the higher education market.

## ACKNOWLEDGEMENT

This study has been fulfilled within the framework of the project TÁMOP-4.2.2/B-10/1-2010-0010 financed by The European Social Fund.

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# GREENHOUSE GAS EMISSIONS AND ECONOMIC GROWTH FOR THE EUROPEAN AGRICULTURAL SECTOR

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## ABSTRACT

The present study surveys the relationship between gas emissions and economic growth for the European agriculture for the time period of 1990-2010, and especially for a new EU member state, Bulgaria. The stationarity of the obtained time series was estimated through the application of the DF - GLS test. The analysis additionally involved a test suggested by Hansen and Seo (2002), in which the null hypothesis of a linear VECM against a threshold VECM with two regimes was surveyed. Initially, the number of regimes was determined in the model with the assistance of the generic functions AIC and BIC. The threshold co-integration extends the concept of the linear co-integration case by allowing the adjustment to occur only after the deviation exceeds some critical point, thus the particular model takes into account possible delays in income adjustment. Furthermore, it allows to capture asymmetries in the adjustment, where positive or negative deviations won't be corrected in the same manner.

## KEYWORDS

Gas emissions, economic growth, Environmental Kuznets curve, co-integration

## 1. INTRODUCTION

Global warming is nowadays one of the most important environmental problems for modern societies. The contribution of carbon dioxide gas emissions to this problem seems to be pivotal. Consequently, reducing gas emissions and in result the extensive use of fossil fuels leading to economic growth, is a necessity for all the countries. On the other hand, the problem can be solved indirectly. This solution presupposes the study of the link between income and gas emissions as presented by Environmental Kuznets Curve (EKC). Studying the long run relationship provides the countries a resort to different policy options in contributing to the fight against global warming (Soytas and Sari, 2006a,b). According to the environmental Kuznets curve hypothesis, there is a relationship between income and environmental performance in terms of a country that is changing form at different stages of economic development (Krueger, 1995). To be more specific, according to the World Bank (1992), many forms of air and water pollution initially worsen but then improve as income rise. This fact implies that the pollution –income relationship takes an inverse U-shaped pattern, and is similar to the Kuznets curve that involves the relationship between income inequality and economic growth. To be more specific the EKC hypothesis argues that the relationship between income per capita and some types of pollution can be attributed by an inverted “U”. In most cases this hypothesis in the existing literature is tested with the assistance of cointegration techniques (Esteve and Tamarit, 2012).

The issue of greenhouse emissions in the sector of agriculture is also important given that according to the estimates of Intergovernmental Panel on Climate Change (IPCC 2001) globally, agriculture's share of total anthropogenic emissions amounts to about 50 % of methane, about 70 % of nitrous oxide, and about 20 % of carbon dioxide (Hynes et.al, 2013). Interest in the area of climate change has significantly increased in both the environmental and economic scientific fields (Chakraborty et al. 2006; Reilly and Richards 1993 and Tol 2001). Environmental issues such as greenhouse gas emission abatement are also increasingly becoming a

more important aspect of EU agricultural reform. Research focused on greenhouse gas emission reduction in a number of EU countries Bulgarian agriculture however, is scarce.

The present paper surveys the validity of the environmental Kuznets curve for the sector of agriculture for an EU country, actually Bulgaria, an ex socialist country. The data employed involve the time period 1990-2010, while the analysis is a two step procedure; in the first step the possible presence of threshold is surveyed, while on the second step the asymmetric movements between the agricultural income and the carbon emissions by agriculture are estimated. In our case the variables are not in per capita but in per Farm Work Unit (FWU) terms. The methodology employed in our study was introduced by Hansen and Seo (2002), who proposed a vector error correction model with a single co integrating vector and a threshold effect based on the error correction term while they developed a supLM test for the presence of a threshold effect, additionally we employed the sup Wald to survey the presence of a threshold. The particular model captures nonlinearities in the adjustment process to the long run equilibrium. To be more specific, it can capture the discrete adjustment given that the movement toward a long run equilibrium might be discontinuous so that the system moves back to the equilibrium only when the deviation from the equilibrium exceeds a critical threshold.

The rest of the paper is organized as follows; the next section reviews the extant literature, whereas section 3 describes the data and methodology employed in our study. Finally, section 4 presents the results and section 5 concludes.

## 2. LITERATURE REVIEW

The issue of environmental Kuznets curve has been a subject of survey in terms of theory as well as empirically. Only a few studies can be found focusing on modeling a direct link between environment and growth, energy and growth or even energy and environment (Soytas and Sari, 2007). On the other hand, this does not hold for empirical studies given that the empirical literature seems to be more abundant (Soytas and Sari, 2007). The EKC hypothesis is based on three major empirical surveys as referred by Kijima et.al (2010); a working paper by Grossman and Krueger, (1993), within a framework of a study on the environmental impacts of NAFTA; the world Development Report as mentioned above conducted by Shafic and Bandyopadhyay (1992); and finally another study focusing on International Labour Organization (Panayotou, 1993).

The majority of theoretical works are based on Solow growth model. Jones and Manuelli (2005), make a review on recent endogenous growth model. On the other hand, Xepapadeas et.al (2005), underline the necessity for growth theory to get an insight to the interrelationships between environmental pollution, capital accumulations and the growth of variables significant in growth theory.

An ample of reasons may well interpret this relationship. A pretty common explanation involves the environmentally sound conscious that is formed to people that have achieved high standard of living (Selden and Song, 1994; Baldwin, 1995). In addition, according to Roca (2003), when income overcomes a particular level then environment becomes an import issue for the citizens, a fact implying a significant increase in their willingness to pay for a clean environment. Furthermore, a structural change is observed to economic systems as their growth reaches satisfactory levels. To be more specific, energy intensive industries are replaced by services, while the investment on Research and Development lead to up gradation of dirty and obsolete technologies to cleaner ones, a fact that leads to an improvement of the environmental quality (Komen et.al, 1997).

All these reasons can be modeled in different ways. To be more specific, the interactions between economic growth and the environmental policy is surveyed by Ricci (2007) who attributes this fact partly to some models treating pollution as an input to production, and others as a negative by-product. As far as the policy effects is concerned, he mentions that generally environmental policies are deemed to have negative effects on growth, because they are taken as additional constraints. Though, in case the environmental improvement results in increased factor productivity and stimulate innovation, the growth prospects will be enhanced.

Within the last few decades, a strand of literature has been developed in order to survey the existence the Environmental Kuznets curve (EKC) hypothesis. The results of the empirical surveys contradict one another, not being able to generate a consensus. Instantly we could mention Ozturk and Acaravci (2010), Halicioglu

(2009), Soytaş and Sari (2003), Soytaş et.al (2001) and many others. The contradicting findings obtained in the aforementioned studies may well be attributed to the fact that the linear approach was adopted to all of them.

Adopting the linear approach implies a linear relationship between the variables, and that the adjustment of the deviations toward the long run equilibrium to be symmetric, constant and reverting. In reality these conditions are not fulfilled, given the existence of policy intervention that may well invalidate the linearity assumption. In case that nonlinearities exist in the behavior of the time series employed in a survey, then linear co-integration may capture only a global behavior, without being able to identify different regimes, within which the time series behavior is non-stationary in a local base.

For the aforementioned reasons the threshold co-integration was employed by Esteve and Tamarit (2012), in order to survey the validity of Kuznets environmental curve in the case of Spain for data overcoming a century and a half. The results confirmed the existence of a threshold result implying the existence of a two regime system. The results found confirmed the inverted U shaped curves for the carbon dioxide emissions, a result that may well be attributed to the econometric methodology employed. The innovation of our study is two – fold. First of all survey the EKC hypothesis for the sector of agriculture, for a new member state of EU, an ex-socialist mainly agricultural country, Bulgaria and secondly the research on the role of CAP on the aforementioned issue.

### 3. DATA AND METHODOLOGY

#### 3.1 Data

The data employed in our study involve, the net income per FWU and the carbon dioxide emissions per FWU. Our data include the time period 1990-2010, while they were derived by FADN and Eurostat respectively.

#### 3.2 Methodology

The present paper employs an extension of linear co-integration, capturing nonlinearities, the name of which is threshold co-integration. In the case of linear co-integration the Vector Error Correction Model of order  $l+1$  generated by a  $p$ -dimensional time series of order 1 that is co-integrated with a  $p \times 1$  co-integrating vector is described by the following mathematical form;

$$\Delta x_t = A'X_{t-1}(\beta) + u_t$$

where;

$$X_{t-1}(\beta) = \begin{pmatrix} 1 \\ w_{t-1}(\beta) \\ \Delta x_{t-1} \\ \Delta x_{t-2} \\ \vdots \\ \Delta x_{t-l} \end{pmatrix}$$

The particular model can be extended to a two – regime threshold cointegration model described by the following mathematical form (Hansen and Seo, 2002);

$$\Delta x_t = \begin{cases} A_1' X_{t-1}(\beta) + u_t & \text{if } w_{t-1}(\beta) \leq \gamma \\ A_2' X_{t-1}(\beta) + u_t & \text{if } w_{t-1}(\beta) > \gamma \end{cases}$$

$\gamma$  denotes the threshold parameter.

The threshold VECM model including two regimes is provided by the following mathematical form;

$$\Delta x_t = A_1' X_{t-1}(\beta) d_{1t}(\beta, \gamma) + A_2' X_{t-1}(\beta) d_{2t}(\beta, \gamma) + u_t$$

where;

$$d_{1t}(\beta, \gamma) = I(w_{t-1}(\beta) \leq \gamma)$$

$$d_{2t}(\beta, \gamma) = I(w_{t-1}(\beta) > \gamma)$$

$I(\cdot)$  denotes the indicator function.

The two regimes are defined by the error correction model, while the matrices  $A_1, A_2$  govern the dynamics in these regimes (Hansen and Seo, 2002). A switch to all coefficients is possible between these regimes, with exception the co-integrating vector  $\beta$ .

The threshold effect is meaningful only in the case where the following equation is valid;

$$\pi_0 \leq P(w_{t-1} \leq \gamma) \leq 1 - \pi_0$$

where  $\pi_0$  denotes a trimming parameter. The value of  $\pi_0$  in our study is equal to 0.05, given that Andrews (1993), argues that the values within the interval  $[0.05, 0.15]$ . For the model estimation the maximum likelihood method was employed while the errors of the model are considered to be iid Gaussian.

## 4. RESULTS

Before estimate the threshold VECM we employed different unit root tests to survey the stationarity of the time series. The first unit root test is the DF GLS test that gave the following results;

**Table 1.** Results of DF-GLS test for the time series of the emissions

DF-GLS test	emissions	income
Level	-0.604420	-1.270292
First Differences	-5.738385	-3.724875

Notes; The critical values for the test with intercept for 1,5,10% level of significance are respectively -2.685718, -1.959071, -1.607456.

It has been empirically confirmed (Dejong et al., 1992), that many tests have low power when the root of the autoregressive polynomial is close to, but less than, unit. Secondly, the majority of the tests suffer from severe size distortions when the moving-average polynomial of the first-differenced series has a large negative autoregressive root (Perron and Ng, 1996; Schwert, 1989). Last but certainly not least is that the implementation of unit root tests perquisites in many cases the selection of an autoregressive truncation lag,  $k$ ; however, as discussed in Ng and Perron (1995) there is a strong association between  $k$  and the severity of size distortions and/or the extent of power loss.

All the aforementioned problems are solved by a test proposed by Ng and Perron (2001). This method includes a class of modified tests, called  $M_{MAIC}^{GLS}$  tests. The particular tests were originally developed in Stock (1999) as M tests, with GLS detrending of the data as proposed in Elliot et al. (1996), and using the Modified Akaike Information Criteria (MAIC). Additionally, Ng and Perron (2001) have proposed a similar procedure to correct for the problems of the standard Augmented Dickey–Fuller (ADF) test,  $ADF_{MAIC}^{GLS}$ .

In Table 2, we report the results of the  $M_{MAIC}^{GLS}$  and  $ADF_{MAIC}^{GLS}$  tests. Based on the results we may conclude that the null hypothesis is that each time series is I(1) against the alternative that it is I(0). Our results clearly reject the existence of two unit roots for the two variables, at the usual significance levels. The null hypothesis of non-stationarity for the two series in levels cannot be rejected in any of the tests. Consequently, we can conclude that both variables are I(1).

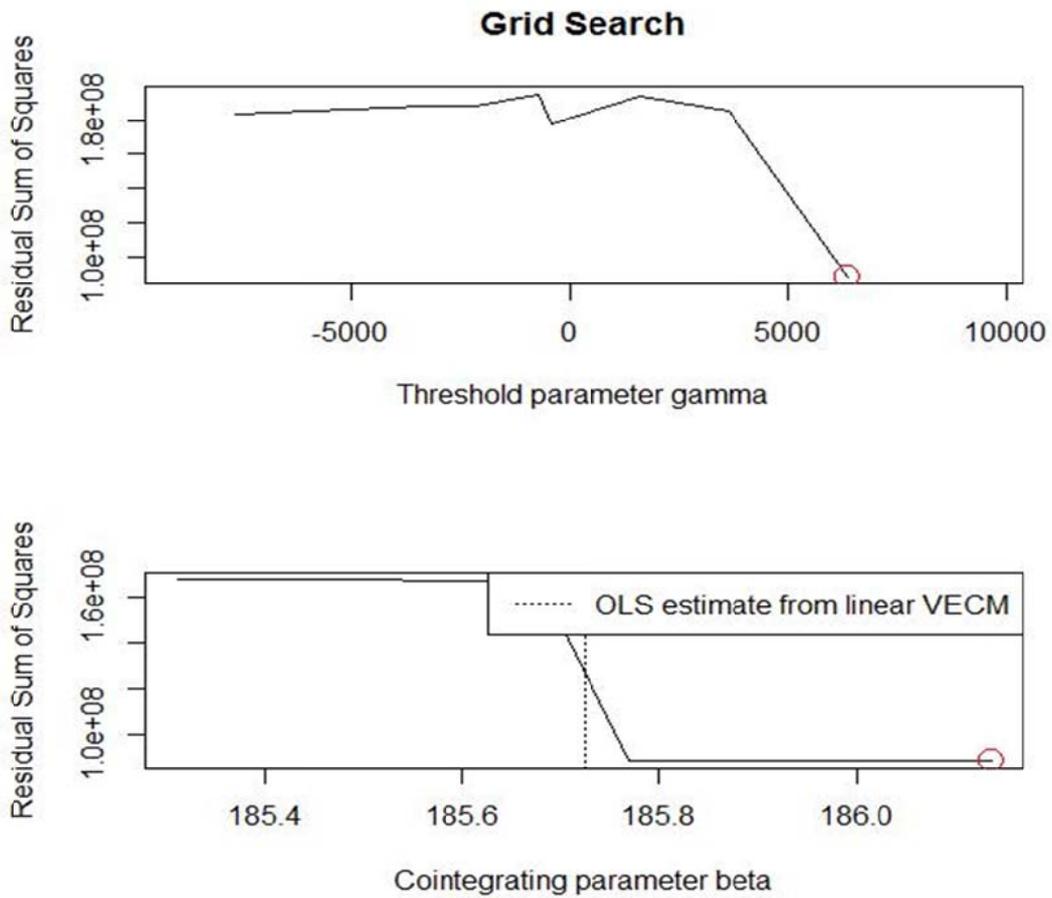
**Table 2.** Ng – Perron test for unit roots

Variable	MZa	MZt	MSB
I(2) vs. I(1)			
D(EM)	-15.133***	-3.0123***	0.24742
D(IN)	-17.5302** *	-3.1255***	0.14501
I(1) vs. I(0)			
EM	-8.52694	-2.03746	0.23894** *
IN	-9.689	-2.29017	0.24242** *
Critical values for lag length p=0	10%	5%	1%
MZa	-14.2000	-17.3000	-23.8000
MSB	0.18500	0.16800	0.14300
MZt	-2.62000	-2.91000	-3.42000

The next step in our analysis involved the application of Hansen and Seo test (2002) based on supLM (estimated  $\beta$ ) to our data. The supLM statistic has a nonstandard asymptotic distribution as shown by Hansen and Seo (2002). Their test applies two bootstrapping techniques for calculating the p-values for supLM test: one is the fixed regressor bootstrap and the other is the residual bootstrap (both are calculated with 5000 simulation replications). According to our findings the null hypothesis of linear cointegration is rejected if the bootstrapping p-values are smaller than the size chosen.

The implementation of the test of threshold co-integration preceded the estimation of the threshold VECM. In our case,  $p=2$  is valid since we have a bivariate system for the per-FWU CO2 and per-FWU agricultural income, where  $\Delta x_t$  corresponds to  $|\Delta em, \Delta in|$  and one co-integrating vector. The selection of the lag length of the VAR, was based on the AIC and BIC criteria, both of them leading to  $l=2$ .

**Figure 1.** Estimation of the threshold parameter gamma and co-integrating parameter beta.



The test statistics and p-values for the model (6) are given in Table 3.

**Table 3.** Tests for threshold cointegration

Estimates	supLM l=2
Cointegrating Vector beta	108.6
Threshold parameter gamma (Antilog)	6835
sup LM test value	25.2
Residual bootstrap CV (p-value)	23.7 (0.035)

Notes; The model estimated is the bivariate specification with the per FWU income and carbon dioxide emissions. The number of bootstrap replications is equal to 5000.

Threshold co-integration would appear at the 2% significance level for the supLM test, with  $\beta$  estimated at 186.6. The implication of this estimated long-run coefficient is that the effect of income on emissions is positive and smaller than 187. The threshold model has two regimes defined by the value of the error-correction term in relation to some threshold  $\hat{\gamma}$ . The results yield a threshold at a per FWU income of  $\hat{\gamma} = 6385$  euros, which divides the sample into two regimes: a first one or typical regime that corresponds to a FWU income <6385 euros (covering 25% of the observations) spanning from 1990 to 1995, and a second one or unusual regime covering the period with per-FWU income  $\geq 6385$  euros (75% of the observations) that corresponds to the 1996–2010 sample period. The estimation of both parameters is evident in figure 1. The traditional linear approach to error correction modeling assumes that the speed of adjustment toward the long-run equilibrium is the same in every time period. The alternative view is that the presence of the error correction is dependent on some threshold. It is conceivable that the error-correction may occur in one regime only, or that the error-correction occurs in both regimes but at different speeds of adjustment on the side both variables. Since the two-regime threshold vector error-correction model is well specified (as evident from Table 4), parameter estimates convey highly interesting results in terms of regime-specific adjustment dynamics.

**Table 4.** Estimation of threshold VECM

Dependent Variable	emissions		agricultural income	
	Regime 1	Regime 2	Regime 1	Regime 2
ECT	-4.854608e-05*** (0.00002)	-0.000435189*** (0.00001)	-0.1235*** (0.1)	-1.740*** (0.2)
emissions t-1	0.2590516 (0.2)	0.0003109093 (0.3)	-4.4163*** (0.132)	-7.5809*** (0.10)
income t-1	9.788658e-05 (0.3)	-1.643315*** (0.4)	0.2488*** (0.10)	2.802*** (0.2)

The estimation of the error-correction term in the VAR lag-length 1, allows for a straightforward investigation into the behavior of the long-run relationship and the asymmetric movements between per-FWU carbon dioxide gas emissions and per-FWU agricultural income in the case of Bulgaria. Additionally, the sign and magnitude of these coefficients can be examined in order to analyze the adjustment process by which long-run equilibrium between the variables is restored. We test whether the error correction term is equal within the two regimes.

The fact that the error correction term is significant in all equations indicates that the error-correction in both regimes is based on the adjustment of both variables, and therefore, the non-linear mean-reverting behavior in both variables is led by a bidirectional interaction that finds a clear theoretical backup in the endogenous nature of both variables.

As mentioned above the threshold co-integration considers the case where the adjustment toward long-run equilibrium does not occur after each small deviation but more realistically only when the deviations exceed some critical thresholds. A comparison of the estimated error-correction coefficients across both regimes suggests that the adjustment process toward the long run equilibrium is relatively faster for both variables in the first or unusual regime than in the second or typical regime.

According to our findings during the first regime, extending from 1990 to 1995, there is a positive relation between the variables employed but the adjustment mechanism is slow up to a threshold level of per FWU income characterized by 6735 euros that corresponds to 1995. From that moment up to 2010 a second co-integrating regime is confirmed where the reaction of both variables to the error-correction mechanism is faster. Although the results report a bidirectional causality in both regimes, the adjustment process is clearly asymmetric.

## 5. DISCUSSION AND POLICY IMPLICATIONS

Within the last decade and especially after the Kioto protocol for all EU member states an effort to reduce gas emissions is required in every sector of the economy. The same is valid for agriculture. What must be underlined is the black box hidden behind the shape of the relationship among the variables studied. This black box does not provide us with the information needed for their correlation. This result can be attributed to the effect of other factors like technology, output composition or environmental policies on the particular relationship. The majority of the studies stress the importance of environmental policies in making the decoupling between economic growth and environmental deterioration. In our case the extensive efforts made to prevent further environment deterioration as implemented through CAP play an extremely significant role in our findings.

The methodology employed in our study (threshold cointegration) can be applied to EKC models since it takes into consideration the transaction costs and optimal adjustments. What is also needed in order to get an insight to the relationship of the two variables includes not only to be aware of the energy consumption but also of the structure of the energy supply (Roca and Alcántara, 2001). The importance of the structure of the energy source as the main driver of CO<sub>2</sub> emissions is a well established fact in the literature. To be more specific according to Marrero (2010) a shifting of the energy mix toward renewable sources, (and to a lesser extent, nuclear) may well yield significant reductions in per capita emissions. Therefore, changes in the structure of energy supply could explain changes in the relationship between income and emissions. This result is valid also for the sector of agriculture, taking into consideration the role of CAP, and the introduction of agroenvironmental policy adapted within the last decade. Consequently for our results may account the CAP policy as well as the introduction of renewable resources to the sector of agriculture.

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## **ANALYSING KNOWLEDGE MANAGEMENT SYSTEM DATABASE**

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### **ABSTRACT**

Knowledge management is an emerging discipline. One of KM's key aspects is also concerned with fostering interaction and collaboration, commonly referred to as "Socialization" (Nonaka). According to Levy KM and Web 2.0 are considerably close to each other. Therefore, it seems interesting to apply Web 2.0 principles to KM. Could these potentially lead to a new era of KM, a "Knowledge Management 2.0"? People are now the generator of knowledge, they social participation grows, they can communicate in a many-to-many model, the culture is changed so they are now more proactive, thanks to the possibility of self-organizing. Social intranet is also a tool to improve the transfer of implicit knowledge. The goal of this research to find a solution, how is possible to gain data about a knowledge management system and how can we use SPSS to analyze it.

The used database is the social intranet of the Professional Coaching Association. The association aims to create an independent and professional coaching community with high credibility, adding value to the society in accordance with the mentality of coaching. It has 15 member, and they organizing a monthly coach forum. The initial communication was email based, but the daily amount of emails were over 30-40 emails, made hard to get the right information. The association is growing; they try to get 120 members to the end of 2013. These are the main reasons why they decided so to choose a social intranet from the open source market. After installing and testing these systems they chose Elgg.

"Elgg is an award-winning open source social networking engine that provides a robust framework on which to build all kinds of social environments, from a campus wide social network for your university, school or college or an internal collaborative platform for your organization through to a brand-building communications tool for your company and its clients" (Elgg.org, 2012). Elgg based on a MySQL database and has 22 tables. The most important table is the `elgg_system_log`, which contains `id`, `object_id`, `object_class`, `object_type`, `object_subtype`, `event`, `performed_by_guid`, `owner_guid`, `access_id`, `enabled`, `time_created` named columns. Each time users annotate, ban, create, delete, login, logout, update a content a new row is created in the `elgg_system_log` table.

My main goal was to export this table from the database and import to the SPSS as a dataset to make a deeper analyze.

### **KEYWORDS**

Knowledge Management 2.0, SPSS, ELGG

### **JEL CLASSIFICATION CODES**

D83

## 1. INTRODUCTION

My research topic is the new wave of knowledge management, which depends on the web 2.0 fundamentals. In this document I try to connect a social intranet database to statistical analysis software to perform deeper data analysis.

## 2. KNOWLEDGE MANAGEMENT 2.0

Knowledge management is a range of strategies and practices used in an organization to identify, create, represent, distribute, and enable adoption of insights and experiences. Since Nonakas first works as identifying this as a discipline, in the practice there were always a big question: Where does the knowledge management belongs in the organization? Should it be at the IT or the HR department? The HR employees often thinks that they should organize learning events and this is will be the knowledge management, IT people like to install new database based applications as knowledge management. These applications can store, summarize and share the knowledge of the workers. As the knowledge management application implementation project finished in an organization, the support from the management fades away slowly and the application becomes dead. The knowledge managers are doing a daily struggle to enhance the knowledge conversion in organizations. Meanwhile a new technological platform is launched, which became an instant success, the Web 2.0. It is a paradigm shift, because the content and the social activity are now in the focus.

After it Web 2.0 became a hit, these tools and conception appeared in corporate environment, names as Enterprise 2.0. The main Enterprise 2.0 applications are Social Collaboration Platform and Social Intranet.

### **Social Collaboration Platform products**

- <http://www.igloosoftware.com/>
- <https://www.yammer.com/>
- <http://www.jivesoftware.com/>
- <http://www.newsgator.com/>
- <http://www.thoughtfarmer.com/>
- <http://www.socialtext.com/>
- <http://www.mindtouch.com/>

### **Social Collaboration Platforms features**

- profile creation using real names
- user groups
- information sharing
- search
- collaboration (groupware)
- messaging, notifications

#### **Social Collaboration Platform basics**

- web 2.0 tools
- every feature can be found on one screen
- integration with other enterprise software
- expandable to extranet
- configurable user roles for each users
- desktop and mobile apps

#### **Social Collaboration Platform tools**

- status upgrade – twitter
- message – facebook
- event
- blog
- wiki
- bookmark
- presentation
- document/file
- photo
- video

### **3. HYPOTHESIS**

My main hypothesis is, that these new kind of knowledge management systems are measurable efficient than the application which were not web 2.0 based.

### **4. ELGG**

To test my hypothesis I choose ELGG, an open source social intranet, which has not so many features, but it is very easy to use, has LDAP authentication, tags, Hungarian language pack, avatars, dashboard, friends, groups, profile option. I saw it working in Graz, the Technical University uses it - <http://tugll.tugraz.at/> . If the features are not enough there is always an option to make a development. I could use the tables from the ELGG social intranet of the Professional Coaching Association. In this document I try to export the ELGG transactional logs and import it into a SPSS dataset.

### **5. DATABASE AND VARIABLES**

The easiest way to put some data in the SPSS's dataset to type in each row or using the copy – paste function from different documents and there will be a possibility to miscopying data.

The next possibility is to import. SPSS can read excel type files. After clicking on File/Open/Data we have to select the file is the one we would like to import. Then the Import Text Wizard appears with the default settings.

## 6. EXPORTING MYSQL TABLES

With the command line mysql client is very easy to create a csv file. We have to create a query which directly writes the output in a file. This is possible with the INTO OUTFILE parameter.

Sample query:

```
SELECT * INTO OUTFILE 'export.csv'  
FIELDS TERMINATED BY ';' OPTIONALLY ENCLOSED BY '"'  
ESCAPED BY '\\'  
LINES TERMINATED BY '\n'  
FROM tablename;
```

## 7. ELGG DATA MODEL

### Elgg Data Model

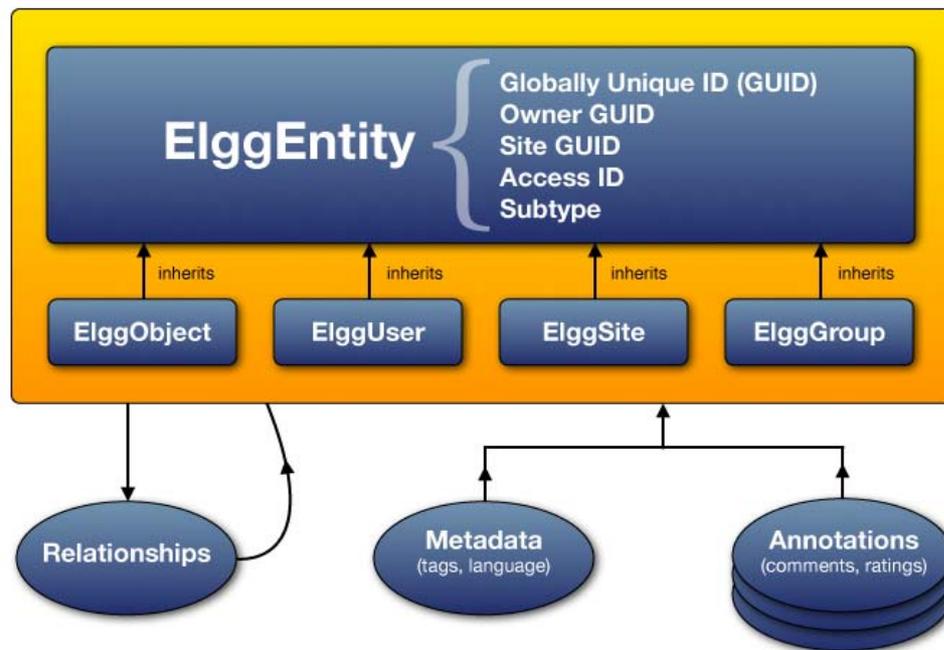


Figure 1. ELGG data model - <http://docs.elgg.org/wiki/Engine/DataModel>

## 8. ELGG DATASHEMA

Table 2. ELGG tables and functions

Table name	Function
elgg_access_collection_membership	connection between access collection and user tables
elgg_access_collections	contains the user access
elgg_annotations	empty table
elgg_api_users	empty table
elgg_config	System parameter can be found here
elgg_datalists	path and cache information are stored here
elgg_entities	entity table
elgg_entity_relationships	shows the relation between entities
elgg_entity_subtypes	description of entities
elgg_geocode_cache	empty table
elgg_groups_entity	user groups access level
elgg_hmac_cache	empty table
elgg_metadata	entity and metadata connection table
elgg_metastrings	metadata description
elgg_objects_entity	objects description
elgg_private_settings	settings
elgg_river	river table
elgg_sites_entity	it contains the site name and url
elgg_system_log	log table
elgg_users_apisessions	empty table
elgg_users_entity	user list
elgg_users_sessions	empty table

The table, which is important to us is the one, where the system log is stored. The default system log is stored in the prefix\_system\_log database table. It contains the following fields:

- id A unique numeric row ID
- object\_id The GUID of the entity being acted upon
- object\_class The class of the entity being acted upon (eg ElggObject)
- object\_type The type of the entity being acted upon (eg object)
- object\_subtype The subtype of the entity being acted upon (eg blog)
- event The event being logged (eg create or update)
- performed\_by\_guid The GUID of the acting entity (the user performing the action)
- owner\_guid The GUID of the user which owns the entity being acted upon
- access\_id The access restriction associated with this log entry
- time\_created The UNIX epoch timestamp of the time the event took place

## 9. ANALYSIS

The following analysis is very easy after importing the log table data into SPSS:

1. transactions and event types
2. users and event types
3. users and transactions
4. time and transactions

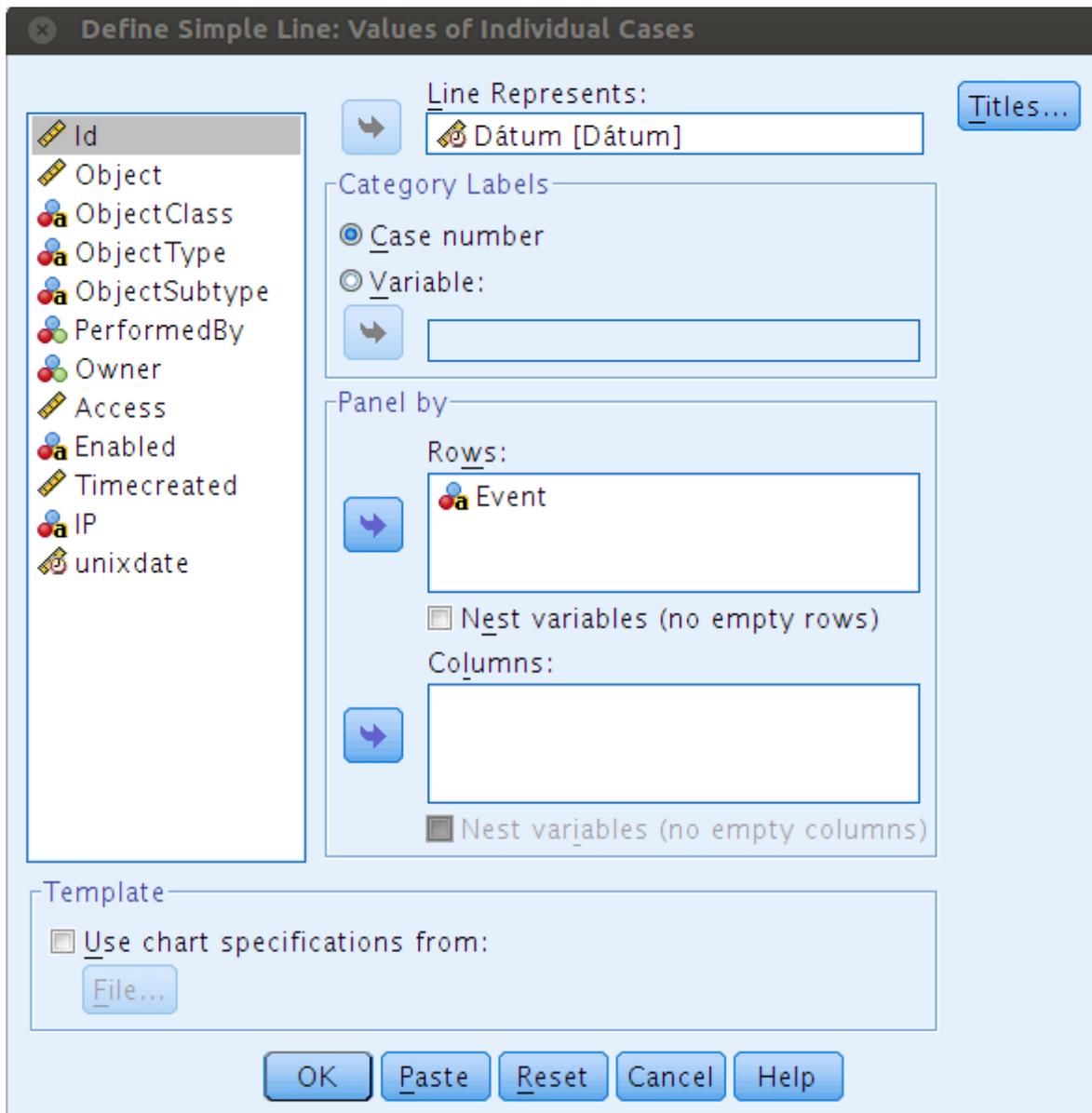


Figure 2. SPSS screenshot

## 10. DATA MODIFICATION

To perform the analysis the last step is to have a date column. The last column in the log table is a Unix epoch timestamp. It is the number of seconds that have elapsed since 1 January 1970. To convert this format to a standard date/time format first we have to create a column, I named it to unixdate, where I copied in each row the 01.01.1970. date. Then I clicked on the Date and Time Wizard menu where I selected the Calculate with Date and Times then Add or subtract duration from a date (e.g., add a month to manage or add a time variable to a date/time variable) and I added the seconds to the unixdate to get the exact date.

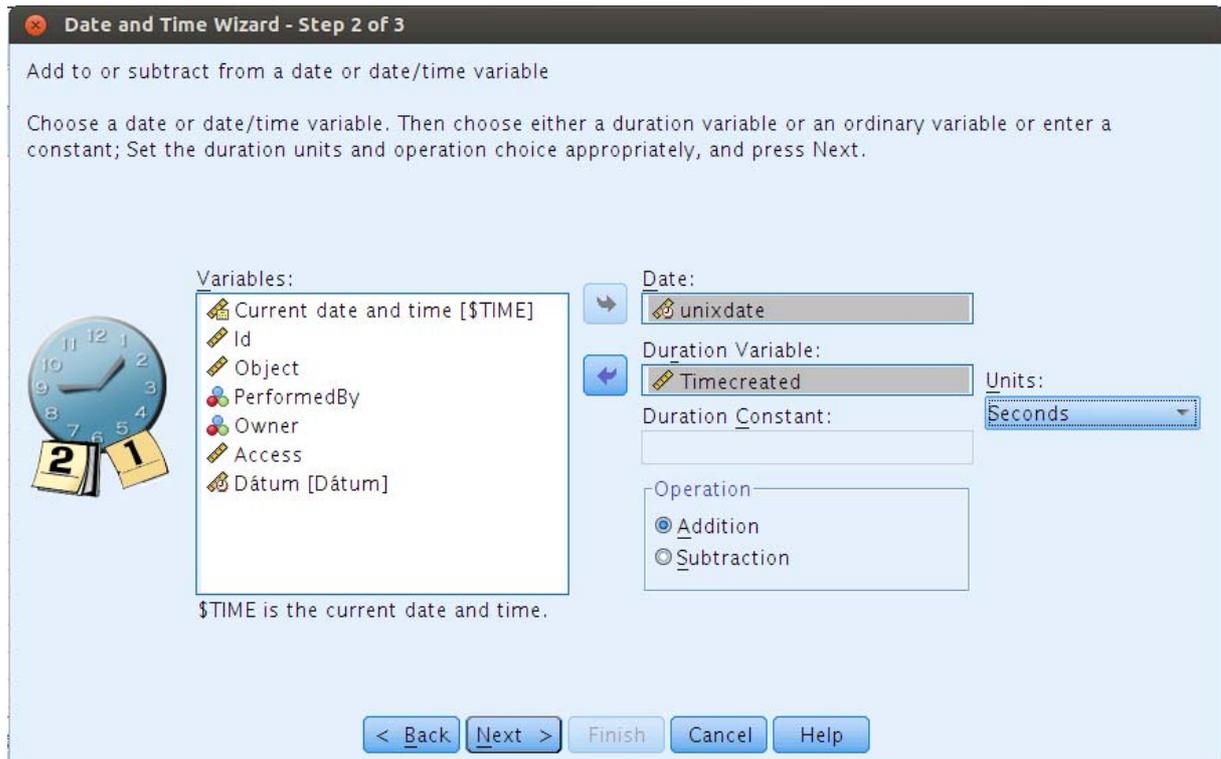


Figure 3. SPSS screenshot

I named the new variable to timecreated.

## 11. CONCLUSION

Now it is possible to make statistical analysis on user transaction and to measure the knowledge transfer. Transaction event type can be annotate, ban, create, delete, login, logout, make\_admin, profileiconupdate, profileupdate, update. Create and update are the key events of knowledge sharing. So my next big question is, what sample size do I need? Should I measure over 100 organizations or over 100 users in 3-5 organizations? How can I compare these indicators with email based knowledge sharing?

## **ACKNOWLEDGEMENT**

This study has been fulfilled within the framework of the project TÁMOP-4.2.2/B-10/1-2010-0010 financed by The European Social Fund.

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# MARKETING STRATEGIES IN GREEK MUNICIPALITIES

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## ABSTRACT

This paper aims to explore the marketing strategies that Greek municipalities adopt and to identify the factors that affect them in their strategic planning. Data were collected through an electronic survey. The questionnaires were sent to the 325 municipalities exist in Greece through e-mail. The productive sample consists of 80 responses (24.6% productive response rate). Principal Component Analysis performed and identified four key factors that affect the formulation of the marketing strategies that municipalities in Greece adopt. These factors are: (a) Market orientation, (b) Revenue improvement, (c) Cost reduction and (d) Adoption of modern financial tools and methods. Hierarchical and k-means cluster analysis conducted to classify the municipalities into strategic groups according to their strategic behaviour. The analysis identified the following three marketing strategies: (i) revenue improvement strategy, (ii) cost focus strategy and (iii) market orientation strategy. Discriminant analysis was performed to assess how the identified factors derived from PCA could predict cluster membership. Non parametric statistical techniques were performed to profile the identified group of consumers regarding the factors that have significant contribution to their economic growth and to forms of tourism that are mainly developed in their area.

## KEYWORDS

Marketing strategies, Marketing in Public Sector, Strategic marketing in municipalities

## JEL CLASSIFICATION CODES

There is a maximum of 3 JEL classification codes. See the following webpage to choose the appropriate classification codes: [http://www.aeaweb.org/journal/jel\\_class\\_system.html](http://www.aeaweb.org/journal/jel_class_system.html)

## 1. INTRODUCTION

Public organizations are significantly different compared to private ones, especially regarding goal and external environment. Hence marketing has to be put into a “public” context, in order to be relevant. In the past marketing has conventionally been viewed by civil servants as irrelevant and antipathetic to the delivery of public services (Laing and McKee, 2001). Reforms started in the eighties mostly in the western countries, encompasses broadly under the term of New Public Management (NPM) have changed this (Tigunas et. al. 2012).

As NPM type reforms have been implemented, administration has become more business orientated in dealing with citizens, facing them as clients and putting them in the center. This gives great opportunity for public leaders to adopt public marketing as a tool of creating an “open, user friendly and close to the citizen” administration (Tigunas et. al. 2012). Marketing can be an important tool for public leaders to promote their organizations interests and objectives in relation to other institutional or political stakeholders. The reluctance of public sector professionals to embrace marketing principles can be viewed as being based on the perception that the public sector and the services it delivers are unique and distinctive, and an adherence of public sector professionals to established transactional conceptualizations of marketing (Laing, 2003).

The concept of marketing can be defined from the public sector view as the activity, set of institutions and processes used to identify, anticipate, create, communicate, deliver and exchange valuable offerings that satisfy clients, audiences, partners, and society at large (Tigunas et. al. 2012). Marketing according to Kotler

and Lee (2007) turns to be the best planning platform for a public agency that wants to meet citizen needs and deliver real value. The central concern of marketing is the production of outcomes that the target market values. In the private sector the main concept of marketing is customer value and satisfaction whilst in public sector is citizen value and satisfaction (Kotler and Lee, 2007).

Marketing tools can be used by managers in public sector in order to explore citizen-customer behaviour and decide on appropriate measures. Information about customers' needs and wants, their attitudes towards the organizations actions, their reactions to proposed projects and the level of complying with certain regulations helps to develop efficient implementations strategies (Snavely, 1991). Marketing is a useful tool on promoting the organizations interest to other public organizations involved in the policy process, especially when leaders need support for larger projects, that involve other public stakeholders such as central government (Tigunas et. al. 2012). This is even more true in the case of local public administration which is confronted with complex situations characterized by increasing responsibilities, diminishing resources from the central budget, increased competition from other local administrations (for attracting resources or investments), increasing expectations on behalf of citizens and the community. In order to function at least acceptable in this difficult environment, public organizations need to develop a clear strategy that will take them a step ahead of other organizations (Hintea, 2008).

In the business literature, there are many studies which develop the business typologies and taxonomies. Miles and Snow (1978) categorized organizations into three basic types according to the way they behave strategically: (i) defender, (ii) prospector, (iii) analyser, with the aim of assessing the dominant culture of the organization. Porter (1980) identified three internally consistent generic strategies for creating a defendable position in the long-run for competitors in an industry. The three generic strategies that a firm may adopt are: (a) overall cost leadership, (b) differentiation, (c) focus. Following on from this, four broad strategies based on the above generic strategies were suggested by Fearnies and Bates (2000): (i) cost leadership, (ii) differentiation strategy, (iii) diversification strategy and (iv) specialization strategy. Modern organisations also adopt alternative strategies such as profit maximization or revenue maximization (Yarrow, 1973; Pantouvakis et. al. 2010).

It can be difficult to use the typologies of business marketing strategies presented above to describe adequately the way public organisation and more particular local public administrations such as municipalities behave, due to their nature, dependence from central budget, competition from other private or local organisations, degree of direct contact with citizens, degree of openness towards the public, quantity and quality of personnel and level of budget allocation for marketing activities.

Some other studies sought to identify the factors that affect tourism and economic development in municipalities. In particular, location, accessibility, diversity of the tourism base, effectiveness of ameliorative planning, environmental factors market decline have significant impact on economic and tourism development (Carreras 1995; Hovinen 1982, Meyer-Arendt 1985; Cooper and Jackson 1989; Urtasun and Gutierrez 2006). Natural features of the environment, man-made features including historic and cultural values, artistic and architectural pieces or even more practical ones such as prices, high level of tourism facilities affect the economic and tourism development of a place (town, village, area) (McIntosh 1977; Goodall and Asworth 1990, Urtasun and Gutierrez 2006). The tourism development of a region has remarkably positive effects, such as maintaining or even increasing the number of inhabitants, balancing the demographic structure, diversifying economic activities, and improving the service network and infrastructure (Kariel 1984; Barbier 1993; Snowdon et al 1999). On the other hand, has negative impacts such as competition between the primary and the tertiary sectors (Messerli 1987), heavy economic, social, and managerial dependence on external influences that increase socioeconomic vulnerability and instability hazards (Dorfmann 1983), and environmental and landscape impacts on the areas that are the most visited (Oberacher 1995; Buckley et al 1999). Furthermore, the structural changes occurred the past few decades in the agrarian sector, manufacturing industries and the expansion of service industries, have brought a concentration of new economic functions (Perlik et.al. 2001). This has resulted in a substantial increase in population and employment opportunities in archetypically rural and tourism mountain regions (Batzing et. al. 1993; Batzing et. al. 1996; Perlik et.al. 2001). Moreover, infrastructure investments, investments in telecommunication, transportation and energy sector have significant impact on the economic development of a region, province, municipality or area (Demurger, 2001).

Most of the extensive research on marketing strategies in public sector and the tourism and economic development focused on survey data in single host communities or in a small number of neighbouring areas which depend on a wide range of idiosyncratic peculiarities. Hence, there is a limited objective evidence

relating to the strategic management process of municipalities and particularly about the factors that influence their choice of a specific marketing strategy. Hence this study, attempts to identify the marketing strategies that municipalities in Greece adopt by using data derived from the Greek municipalities. The aim is to profile each of the identified marketing strategic groups in the local public administration sector regarding the: (a) sectors which are important to municipalities' economic growth and (b) tourism activities have been developed within municipalities' area.

Moreover, this study aims to identify the marketing strategies adopted by Greek municipalities as the New Public Management, strategic and marketing management are raising in high priority issues due to the obligation of the Greek State for its financial support by the E.U., IMF and European Central Bank. Greece in order to achieve a fiscal reconciliation should reduce its budget deficit and debt (Theodoropoulos 2010). Moreover, the Greek Government among the other measures that has to implement, should re-organise the public sector, reduce the operational costs of the local governmental bodies and increase their efficiency productivity. Hence, the exploitation of the marketing strategies local authorities and more particular municipalities adopt in Greece within the fiscal reconciliation period are quite important and crucial issues.

This study after the introductory section presents next the conceptual model of the study, the research hypotheses, the survey and statistical methodology as well as the results of the analysis and the concluding remarks.

## 2. METHODS

### 2.1 The Conceptual Model

A conceptual model was developed to place key concepts outlined in the literature into an identifiable framework (Figure 1). In particular it tries to investigate the relationships between aspects of the internal and external environment of the municipalities and the development of strategic dimensions that may influence them to adopt a specific marketing strategy, as well as to profile the Greek Municipalities who follow a particular marketing strategy regarding the: (a) sectors which are important to their (municipalities) economic growth and (b) tourism activities have been developed within municipalities' area.

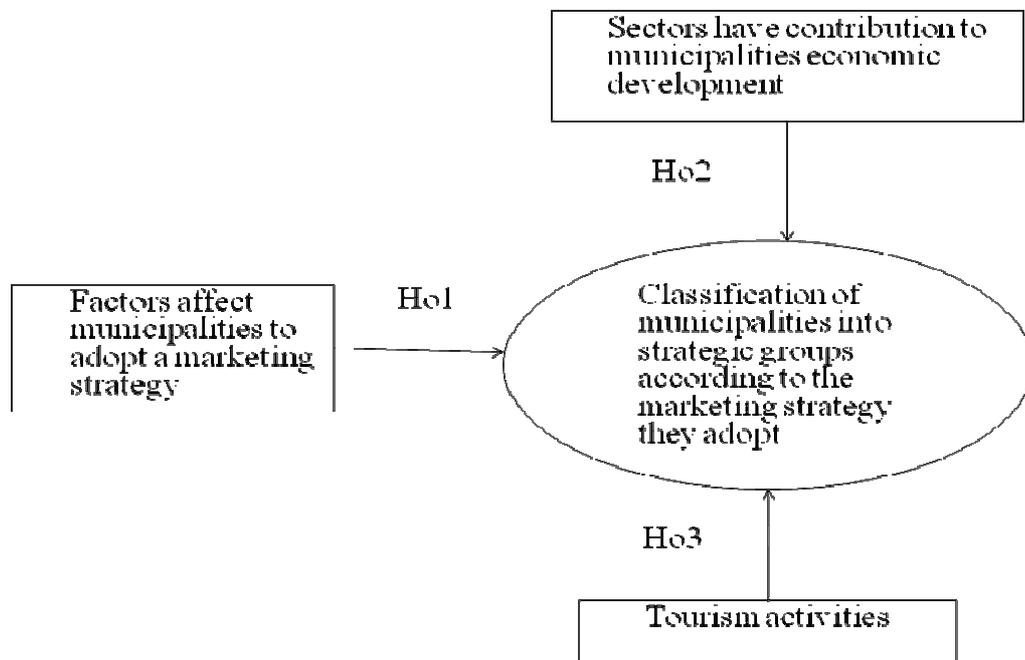


Figure.1: The Conceptual Model

The null research hypotheses that this study tests to reject according to the conceptual model above are the followings:

- Ho1: Greek municipalities cannot be classified into strategic groups according to the marketing strategy they follow.
- Ho2: There is not any significant association between the marketing strategy followed by a Greek municipality and the existence of particular sectors contributed to its economic development.
- Ho3: There is not any significant association between the marketing strategy followed by a Greek municipality and the development of particular tourism activities.

## 2.2 Survey Procedure

The researchers undertook a postal survey in order to gather data from the Greek municipalities. A sample frame including information of 325 municipalities operated in Greece. The researchers sent the questionnaires to the whole sample frame through e-mails. In particularly the survey was pre-tested on four municipalities operated in the Region of East Macedonia and Thrace. As a result minor alterations were made to the questionnaire prior to the pilot survey. In Autumn of 2012 a pilot postal survey was conducted with 16 municipalities from North Greece. The purpose of the pilot survey was to test and validate the questionnaire design and to estimate the response rate of the main survey. Thus the main survey comprised 305 municipalities began in December 2012 and was completed in February 2013. The response rate post reminder reached the 26% and hence 80 completed questionnaires consists of the productive sample.

## 2.3 Questionnaire design

The questionnaire was designed taking into consideration the marketing and strategic variables identified in the literature regarding marketing in business and public organisations and strategic management. As a starting point, attention was given to existing conceptual frameworks such as Porter's (1980) generic strategies, Miles and Snow's (1978) strategic typologies, Fearnies and Bates (2000) strategic taxonomy, Yarrow's (1973) alternative strategies and Pantouvakis et. al. (2010) port's marketing strategies. This was followed by informal interviews with officers and civil servants in local public administrations and municipalities sector as well as academics in order to gain a detailed knowledge of the industry prior to selecting the variables. Finally, a six-page questionnaire was designed to identify the marketing strategies that were used by municipalities, their strategic goals, the economic sectors are most developed in there are and the factors that contribute to their economic development.

## 2.4 Statistical Methodology

Multivariate analysis techniques were used to the 80 municipalities to reveal the key information contained in the responses, and these analyses were applied in three stages. First, principal component analysis (PCA) was used to identify the variables that accounted for the maximum amount of variance within the data in terms of the smallest number of uncorrelated variables (components) The anti-image correlation matrix was used as well as Bartlett's test of sphericity and measure of sampling adequacy (MSA) in order to check the appropriateness of the data for subsequent factor analysis. The variables that had a high proportion of large absolute values of anti-image correlations as well as MSA less than 0.5 were removed before analysis.

In this study, PCA reduced the 17 key strategic variables, which relate to various aspects of municipalities strategic behaviour to a smaller set of underlying factors (or strategic dimensions). An orthogonal rotation (varimax method) was conducted and the standard criteria of eigenvalue = 1, scree test and percentage of variance were used in order to determine the factors in the first rotation (Hair et al. 1998). Different trial rotations followed where factor interpretability was compared. These PCA scores were then subjected to cluster analysis to group municipalities with similar patterns of scores into similar clusters based on their strategic behaviour. In this study, both hierarchical and non-hierarchical methods were used according to the recommendations of Hair et al. (1998) and Punj and Stewart (1983) in order to develop a typology of the municipalities marketing strategic behaviour.

Quadratic discriminant analysis was performed to assess how accurately the identified key strategic dimensions that were derived from the PCA analysis could predict and discriminate cluster membership.

Statistical tests based on the outcomes of the multivariate statistical techniques presented above (factor, cluster and discriminant analysis) and the one-way Friedman non parametric test were used to test the three null hypotheses presented in previous section.

### 3. RESULTS

#### 3.1 Factors affecting municipalities' marketing strategic

Principal components and factor analyses (through a varimax rotation) were conducted to identify the key strategic variables, and the latent root criterion (eigenvalue =1), and the percentage of variance were used to determine the number of factors (Table 1). Several different trial rotations were conducted to compare factor interpretability as suggested by Tabachnick and Fidell (1989) and Hair et al (1998).

Table 1: Results of Principal Components Analysis regarding the identification of the key factors that affect municipalities marketing strategic behaviour behavior

Component	Eigenvalues	% of Variance	Cumulative % of Variance	Variables	Communalities
1	7.167	42.158	42.158	Reduction of operational cost	0.655
2	1.861	10.944	53.103	Reduction of cost regarding public investments	0.598
3	1.448	8.517	61.620	Cost reduction through proclamation	0.691
4	1.203	7.078	68.698	Use of electronic procurement's methods	0.681
5	0.816	4.802	73.500	Use of modern financial tools	0.800
6	0.791	4.650	78.150	Continuous monitoring of the expenses	0.508
7	0.747	4.393	82.543	Finding economic resources from E.U.	0.588
8	0.646	3.801	86.344	Continuous seeking of European Union programs in order to apply for funded projects	0.671
9	0.473	2.784	89.128	E.U. funded projects derived from external consultants ideas	0.601
10	0.396	2.328	91.457	Revenue increase through retributive services	0.690
11	0.317	1.862	93.319	Continuous effort for better satisfaction of citizens' requirements.	0.629
12	0.304	1.788	95.107	Consider citizens as clients	0.612
13	0.290	1.704	96.810	Existence of procedures for complaints' submission by citizens and their resolving	0.617
14	0.217	1.274	98.085	Good reputation regarding quick satisfaction of citizens' queries	0.873
15	0.178	1.048	99.133	Good reputation regarding their flexibility in solving problem	0.816
16	0.082	0.484	99.617	Good reputation regarding their better economic efficiency	0.830
17	0.065	0.383	100.00	Good reputation regarding their effort for cost reduction	0.821

PCA identified four key factors that affect municipalities marketing strategic behaviour (Table 2).

Table 2 The main factors that affect municipalities strategic behaviour derived from Principal Component Analysis.

<b>KEY STRATEGIC DIMENSIONS</b>	<b>Factor Loadings</b>
<b>Market Orientation</b>	
Good reputation regarding their flexibility in solving problem	0.845
Good reputation regarding quick satisfaction of citizens' queries	0.838
Good reputation regarding their better economic efficiency	0.818
Good reputation regarding their effort for cost reduction	0.788
Continuous effort for better satisfaction of citizens' requirements.	0.749
Existence of procedures for complaints' submission by citizens and their resolving	0.676
Continuous monitoring of the expenses	0.543
<b>Revenue Improvement</b>	
Continuous seeking of European Union programs in order to apply for funded projects	0.735
E.U. funded projects derived from external consultants ideas	0.717
Finding economic resources from E.U.	0.688
Revenue increase through retributive services	0.670
Consider citizens as clients	0.652
<b>Cost reduction</b>	
Reduction of operational cost	0.767
Reduction of cost regarding public investments	0.739
Cost reduction through proclamation	0.588
<b>Adoption of modern financial tools and methods</b>	
Use of modern financial tools	0.881
Use of electronic procurement's methods	0,744

KMO MSA = 0.821

Bartlett test of Sphericity = 852.538, P <0.001

In the next stage, hierarchical and non-hierarchical clustering methods were used to develop a typology of the marketing strategies that municipalities follow in Greece (Harrigan 1985; Helsen and Green 1991; Hair et al. 1998; and Siardos 1999). Cluster analysis was conducted on the 80 observations, as there were no outliers.

It identified three marketing strategies that Greek municipalities may follow (Table 3). These are: (a) the "Revenue Improvement Strategy" consumers, (b) the "Cost Reduction Strategy" and, (c) the "Market Orientation Strategy".

In particular, the **revenue improvement strategy** was preferred by 21.3% of the examined municipalities. These municipalities are very interested in implementing E.U. funded projects and to find resources funded by E.U. such as personnel. Moreover, they cooperate with external consultants in order to design or implement E.U. funded projects. They also aim to increase their revenues through the development of retributive services as well as by using modern financial tools. On the other hand, they are not interested in cost reduction but they face citizens as clients.

The **cost reduction strategy** was preferred by 40% of the sample. These municipalities make efforts to reduce their operational cost as well as the cost for public investments. In order to reduce their cost they proceed to their procurements either after proclamation or through electronic auctions as well as by using modern financial methods and tools such as leasing.

Finally the market orientation strategy was followed by 38.7% of the sample. They are highly interested in developing good reputation regarding their ability in problem solving, quick satisfaction of citizens' queries and their better economic efficiency. They also aim to cost reduction as well as they monitor their expenses continuously. Besides they make a continuous effort for better satisfaction of citizens' requirements and they developed procedures for complaints' submission by citizens.

Table 3 The Marketing Strategies followed by Municipalities

Key Consumption Dimensions	Revenue Improvement Strategy	Cost Reduction Strategy	Market Orientation Strategy	P
Marketing Orientation	0.05278	-1.13726	0.56917	0.001
Revenue Improvement	0.56467	-0.28965	-0.42404	0.001
Cost Reduction	-0.63216	0.71580	0.26002	0.001
Adoption of modern financial tools and methods	0.46119	0.55033	-0.77786	0.001
Number of consumers (n=80)	32	17	31	

Moreover discriminant analysis was conducted to evaluate the prediction of group membership by the predictors derived from the factor analysis. Initially the normality of the key strategic dimensions was checked. The Box's M test statistic (Box M= 40.268 approx F= 1.844, df =20 P<0.05) indicated that the variance – covariance matrices were violated.

Thus, the Bartlett Box F statistic and the Levene's Test were conducted additionally using Minitab to assess the homogeneity of variance for each dependent variable (Siardos 2000). The summary of the cross validation classification derived by the quadratic discriminant analysis is shown in Table 4.

Thus, the seventeen consumption dimensions could accurately predict and discriminate consumers' group membership.

Therefore, the hypothesis **H01**: Greek municipalities cannot be classified into strategic groups according to the marketing strategy they follow may be rejected.

Table 4 Summary of Classification with Cross – validation

Actual Classification	Predicted Classification		
	Revenue Improvement Strategy	Cost Reduction Strategy	Market Orientation Strategy
Revenue Improvement Strategy	31	1	1
Cost Reduction Strategy	1	16	0
Market Orientation Strategy	0	0	30
Total N	32	17	31
N correct	31	16	30
Proportion of Correct Classification	96.88%	94,10%	96,80%
N = 80	N correct=77	Proportion Correct	96.25%

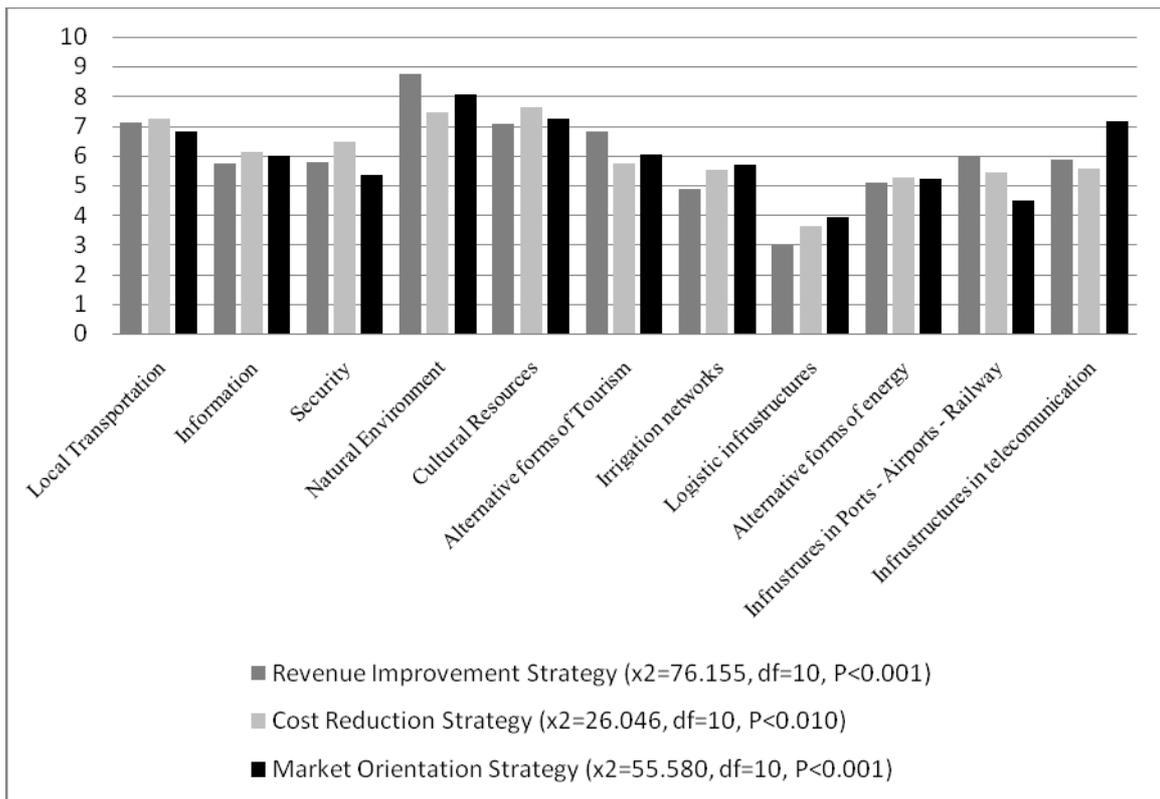


Figure 2: The importance of each economic sector for each marketing strategy

### 3.2. The association between municipalities marketing strategies and sectors of economic development and tourism

The non parametric Friedman one way test performed to identify the importance of sectors that have significant contribution to municipalities economic and tourism development for each strategic group.

As the statistical analysis indicates (Figure 2), almost the same sectors of economic development are crucial for each marketing strategy but the importance of each sector is different for each strategic group. The natural environment, local transportation, cultural resources and alternative forms of tourism are the most significant sectors (in a rank of importance) for the municipalities that adopt the revenue improvement strategy. For the cost reduction strategy the most important factors are the cultural resources, the natural environment, local transportation and the security and safety issues. On the other hand, natural environment, cultural resources, infrastructures in telecommunication and local transportation are the most crucial sectors of economic development in a rank of importance for the municipalities who follow the market orientation strategy.

Thus, the null hypothesis **Ho2**: There is not any significant association between the marketing strategy followed by a Greek municipality and the existence of particular sectors contributed to its economic development may be rejected.

Furthermore, the Friedman test showed (Figure 3) that almost the same types of tourism development are significant associated with market orientation and revenue improvement strategies but the importance of each type differ for each strategic group. More specifically, the municipalities that adopt the revenue orientation strategy mainly aim to conference tourism, sport tourism and agro-tourism development. On the other hand, the market orientated municipalities mostly pay attention to conference tourism, sport tourism and classical tourism development. No significant association found between cost focus strategy and different types of tourism development.

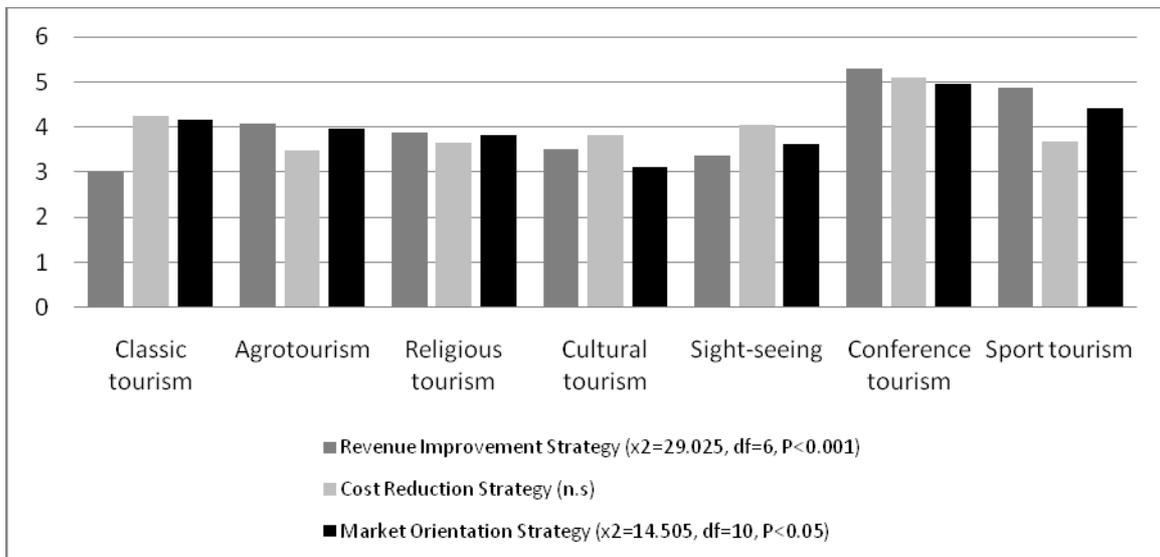


Figure 3: The importance of each type of tourism development for each marketing strategy

Hence, the null hypothesis **Ho3**: There is not any significant association between the marketing strategy followed by a Greek municipality and the development of particular tourism activities may be rejected.

#### 4. DISCUSSION -CONCLUSIONS

This study indicated that Greek municipalities adopt one of the following marketing strategies: (a) revenue improvement strategy, (b) cost focus strategy and (c) market orientation strategy. It also found that there is a significant association between the marketing strategy selection by the municipalities and the sectors which are most important for their economic and tourism development.

From a theoretical perspective, this study further contributes to the understanding of the municipalities' marketing strategy selection. In particular, none taxonomies and typologies referred in the literature review represent the marketing strategies followed by the Greek municipalities. The marketing strategies this study identified are quite different from those presented by Porter (1980), Ansoff (1978) and Fearnies and Bates (2000). Only the revenue strategy presented by Yarrow (1973) and Pantouvakis et. al. (2010) are quite similar to the revenue improvement strategy followed by some Greek municipalities. On the other hand, the cost focus strategy is mainly followed by the municipalities in Greece as a result of Greek States' policy due to its effort for fiscal reconciliation and mostly aims to cost reduction rather than to cost leadership. The market orientation mainly aims to the establishment of a good reputation on citizens mind rather than differentiating the municipality from others municipalities which might act competitively in tourism or other economic sectors.

Moreover, the factors including cultural recourses, natural environment, local transportation, infrastructures in telecommunication, information, railways, ports and energy, irrigation networks, alternative forms of tourism and security issues that contribute to municipalities economic development are in accordance with the factors presented in the literature review (McIntosh 1977; Hovinen 1982, Dorfmann 1983; Kariel 1984; Meyer-Arendt 1985; Messerli 1987; Cooper and Jackson 1989; Goodall and Asworth 1990; Barbier 1993; Carreras 1995; Oberacher 1995; Batzing et. al. 1996; Buckley et al 1999; Snowdon et al 1999; Perlik et.al. 2001;Urtasun and Gutierrez 2006;).

From the managerial point of view this study indicated that most of the municipalities who follow the revenue improvement strategy base their economic development to their natural environment, cultural resources, local transportation and alternative forms of tourism. The cost focused municipalities consider that the most important sectors for their economic development are their cultural recourses, natural environment, local transportation and security issues. Natural environment, cultural resources, infrastructures in telecommunication and local transportation are the most important sectors for the economic development of the market orientated municipalities.

A general limitation identified in this survey is the reluctance of the officers in some municipalities to answer the questionnaires but this limitation exists in most of this kind of surveys in Greece.

Nevertheless, the value of the current study is incontestable. It is the first study (to the knowledge of the authors) that explores the marketing strategies of municipalities in a South European country that its economy is under fiscal reconciliation by the supervision of IMF, European Union and European Central Bank and more particular in Greece by providing managerial and theoretical implications. It also indicates that Greek municipalities started implement New Public Management issues and their administrations became more business orientated supporting in the argument presented by Tigunas et. al. (2012). This paper also identified that municipalities in Greece focus on citizen satisfaction as the public marketing concept supports (Kotler and Lee (2007). Generally, is clear that the municipalities operated in Greece understand the need to develop clear strategies which will take them one step forward as Hintea (2008) stated.

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# **THE INFLUENCE OF MEDIA, INTERNET AND INFORMATION SOURCES ON BUYING DECISION PROCESS AND DESTINATION CHOICE. THE CASE OF AN ESTABLISHED MEDITERRANEAN DESTINATION**

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## **ABSTRACT**

This research paper examines the influence of several information sources, media, popular culture and promotion techniques on the formation of the buying decision process and final tourism destination choice. The consumer buying process and the choice which concern a tourism destination are influenced by several factors. Among them there is the flood of information which has many sources including promotion (advertising and brochures), the opinions of others (family/friends, travel agents), media reporting (newspapers, magazines, television news reporting and documentaries) and popular culture (motion pictures, literature) and of course Internet. This flood of information creates also an image. This article reports the findings of a research, conducted in an established Mediterranean island destination, in which 376 respondents from Britain had already chosen the island as a vacation destination by using several promotional sources. The study implements descriptive statistics and factor analysis in order to discover the most influential promotional tools and to shape these tools into variables which operate as ‘‘influential promotional factors’’. The study examines simultaneously and comparatively several information sources. The findings reveal that tourism authorities need to understand that successful tourism promotion is dependent on a broad range of information influences that are subject to evolution and changes. Therefore, they should assess the impact of their promotional decisions within the realm of a destination’s overall marketing communication strategy.

## **KEYWORDS**

Information sources, influences, tourism promotion, destination choice, destination image.

## **JEL CLASSIFICATION CODES**

M31, M37

## **1. INTRODUCTION**

In the competitive tourism environment of our days, the Destination Management Organisations (DMOs) make substantial efforts to attract visitors by using several ways and tools. One important tool is the travel information distributed by several media and sources.

The body of literature establishes that among other factors, the information sources at which the individuals are exposed, influence the forming of destination perceptions prior to the visit (Um and Crompton, 1990).

Potential foreign visitors have limited knowledge of destinations they haven’t previously visited (Chon, 1991, Sonmez and Sirakaya, 2002). As a consequence, they largely depend on several information sources. Phau, Shanka and Dhayan, (2010) found that tourism information sources have a considerable influence on perceived destination image and destination choice intention.

In these image studies, some researchers have demonstrated the importance of travel information. They have found that the type and amount of information significantly influences the formation of positive destination

image (Fakeye and Crompton, 1991; Mansfeld, 1992; Gartner, 1993; Baloglu, 1999; Baloglu and McCleary, 1999; Beerli and Martin, 2004; Prebensen, 2007).

Therefore, DMOs have sought cost-effective marketing techniques to provide travel information to potential visitors (Kaplanidou and Vogt, 2006). The travel information has many sources including promotion, advertising, classical and electronic brochures, the opinion of friends, family, relatives, the opinions of the professionals (such as travel agents and the tour operators), media reporting (newspapers, magazines, tv news and documentaries), films, literature and the several forms of Internet such as websites, blogs, social media etc. This flood of information sources has a dynamic nature and creates images. Images capable of affecting consumer behaviour, creating intentions and triggering the buying decision process.

Therefore, the purpose of this study is to understand the influence of several information sources on the buying decision with specific focus on an established and worldwide known destination, the island of Corfu in Greece. In our days the need to understand the information sources' influence is more intense than ever, not only because of the fierce competition but also because of the changes to the way potential visitors gather information and consider the alternatives.

Despite the fact that there are a lot of studies that examine the influence of information sources there is a lack of research in studies which examine simultaneously and comparatively this influence among them. This is where this study aims to make a contribution.

## **2. THEORETICAL BACKGROUND – LITERATURE REVIEW**

Information sources—also known as stimulus factors (Baloglu and McCleary 1999a) or image forming agents (Gartner 1993)—are the forces which influence the forming of perceptions and evaluations.

They refer to the amount and diverse nature of information sources to which individuals are exposed, including destination information acquired as a result of having visited the place. From the perspective of behavior in the choice of a destination, various authors (Fakeye and Crompton 1991; Gartner 1993; Mansfeld 1992; Um and Crompton 1990; Woodside and Lysonsky 1989) have proposed models that attempt to explain this behavior. They establish that, together with a number of other factors, the information sources to which the individuals are exposed determine that certain destinations are considered possible alternative choices.

Gartner (1993) believes that the image forming process can be regarded as a continuum of different agents or information sources which act independently to form one single image in the mind of the individual. He classifies the different agents as (a) overt induced, found in conventional advertising in the mass media, from information delivered by the relevant institutions in the destination or by tour operators and wholesalers, travel literature, Internet (b) covert induced, using celebrities in the destination's promotion activities or destination reports or articles (c) autonomous, including mass-media broadcasting news, documentaries, films, television programs, etc., about the place (d) organic, involving such people as friends and relatives, giving information about places, based on their own knowledge or experience, whether the information was requested or volunteered and (e) a visit to the destination, the end point of the continuum of the forming process, which forms the primary sources of information. And all the others mentioned above form the secondary sources.

Mansfeld (1992) demonstrates that there is general agreement, although not based on empirical evidence, that the secondary sources of information fulfil three basic functions in destination choice: to minimize the risk that the decision entails, to create an image of the destinations, and to serve as a mechanism for later justification of the choice.

## **3. OBJECTIVES OF THE STUDY**

Therefore, this study aims:

- To identify the influence of several information sources after the destination choice has been made.
- To identify the influence that each one of the several information sources had on the decision making process (because of that respondents are asked after the purchase decision has been made).

- To identify the influence of each information source in relation to the demographic characteristics of the respondents.
- To identify the grouping of the information sources, used in this study, into factors in order to compare them with the literature's categorisation.
- To offer marketing-management implications

So, the study assesses simultaneously and comparatively, the several information sources and examines the relationships among them that could reveal possible shifts in perception. The above objectives are important in terms of influence assessment and marketing management strategies orientation.

## **4. METHODOLOGY AND RESEARCH DESIGN**

### **4.1 Research design and survey sites**

In order to achieve the objectives of the study primary quantitative research was conducted. The implementation of the research and the collection of the primary data took place in the tourism destination of Corfu island. This destination is an established Mediterranean destination and could be considered as a miniature of Greek tourism. Also, it is a traditional destination for the British target market. So, the nationality of the sampling population was decided to be British, since they represent one of the two basic target markets of Corfu and Greece in general.

### **4.2 Sampling and data collection**

The relationship between secondary information sources and influence on decision making can only be analyzed in the case of first-timers since repeat tourists could have difficulty recalling the sources of information used before visiting the place for the first time. Therefore, the sample was decided to be first time visitors.

The study needed a representative sample from the population of its main tourism generating country. Therefore, it was essential that the sample should not be chosen by convenience. Additionally, in order to fulfill better the objectives of the study the respondents were asked after the purchase decision had been made.

The sample is stratified, because is probability sample and more representative. The members of the sample (British first time visitors) were chosen by random sampling. Special attention was given in order to have responses from all hotel categories and other accommodation types (apartments, villas etc.) from all parts of the island (which were defined as strata).

### **4.3. Sample size**

The final sample size obtained was 376 British tourists/first time visitors. This sample size ( $n=376$ ) gives a statistical error ( $e \approx 5\%$ ).

Level of significance  $\alpha=0,05$

Level of confidence 95%

### **4.4 Questionnaire design and content**

The questionnaire was structured and self administrated. It comprised closed-end and open-end questions. The closed-end question had a five-point rating scale. All the rating scales were labeled. For the statistical analysis and the interpretation of the results the five-point scale of the questions was coded from 5 to 1, (5=very influential, 4=influential, 3=neither influential nor uninfluential, 2= uninfluential, 1=very uninfluential). The final part was designed to obtain demographic data from the respondents.

## 4.5 Profile and description of the sample

Female respondents represented 57%, or 216 persons, male respondents represented 43%, or 160 persons out of a total of 376. Also, 44% of the sample is between the ages of 35 and 54 years. The other age categories are represented with the percentages of 27% for the under 34 age group and 29% for the 55+ group. The income brackets “>£20.000” and “£20.001 - £40.000” are represented with 36% and 41% respectively. Their percentages are increased compared to the income bracket of “£40.001+” that is only 23%. The educational levels are Secondary/Technical 37%, Higher Technical 34% and University/Postgraduate 29%

## 4.6 Research methodology

### 4.6.1 Results, findings from the descriptive statistics

In order to find the most influential information sources the means for all the variables were examined by using descriptive statistics

Table 1. Influential information sources according to the total sample

SECONDARY INFORMATION SOURCES	Total
	mean
1. Newspapers	2.21
2 TV / Radio commercials	2.19
3. Magazines	2.43
4. Radio	1.97
5. Family/Friends/Relatives recommendations	3.71
6. Travel brochures (classical and electronic)	4.00
7. Travel Agencies (personal contact and advise)	3.73
8. Travel books, travel magazines	3.35
9. Movies	2.09
10. Books	2.32
11. Internet (websites, blogs, facebook etc.)	3.58

The observation of the data leads to a series of findings. Specifically:

- The undoubted influence of “word of mouth publicity” on a personal, face to face level that concerns all the demographic variables. An influence that remains unchanged through the years, especially in the field of tourism, due to the fact that the product is an intangible experience. Therefore, the final buying decision is based greatly on the recommendations from friends and relatives.

- The increasing influence of Internet, either in the form of websites or social media and blogs. A careful observation of the data reveals that this influence is more intense in the younger ages, the higher educational levels and medium income levels.

- Another important issue revealed, that DMO’s should take under consideration when planning campaigns, is the influence of the travel trade information sources. The tour operators and travel agencies, through their information sources (personal contact and classical or/and electronic brochures) proved to be very influential on the final buying decision. This observation concerns all the demographic segments without exceptions.

This finding proves, once more, the manipulative power of tour operators and travel agencies on the demand and sales of the Greek tourism product. Additionally, this is in accordance with the fact that destinations at different stages of their life cycle are affected by different information sources (Kotler, 2000). When a destination has reached its establishment the travel trade information sources are the most influential (Buhalis, 2000). At the same time this finding confirms the need of effective communication strategies within the distribution channels and proves the validity of the findings of the present study.

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Table 2. Influential information sources according to the demographic variables of gender and age

SECONDARY INFORMATION SOURCES	Total	Gender		Age		
		Male	Female	18-34	35-54	55+
	mean	mean	mean	mean	mean	mean
1. Newspapers	2.21	2.24	2.19	2.20	2.11	2.36
2 TV / Radio commercials	2.19	2.23	2.16	2.26	2.14	2.19
3. Magazines	2.43	2.43	2.42	2.58	2.37	2.37
4. Radio	1.97	1.94	2.00	2.05	1.94	1.95
5. Family/Friends/Relatives recommendations	3.71	3.59	3.80	3.89	3.63	3.67
6. Travel brochures (classical and electronic)	4.00	3.99	4.00	4.12	3.92	4.01
7. Travel Agencies (personal contact and advise)	3.73	3.71	3.75	4.00	3.75	3.46
8. Travel books, travel magazines	3.35	3.33	3.36	3.35	3.31	3.41
9. Movies	2.09	1.99	2.17	2.14	2.14	1.97
10. Books	2.32	2.19	2.41	2.26	2.35	2.32
11. Internet (websites, blogs, facebook etc.)	3.58	3.60	3.56	4.05	3.66	3.03

Table 3. Influential information sources according to the demographic variables of education and income

SECONDARY INFORMATION SOURCES		Education			Income		
		Secondary/ Technical	Higher Technical	University	under £20000	£20001-£40000	£40001+
	mean	mean	mean	mean	mean	mean	mean
1. Newspapers	2.21	2.31	2.14	2.15	2.34	2.00	2.39
2 TV / Radio commercials	2.19	2.31	2.15	2.07	2.34	2.08	2.13
3. Magazines	2.43	2.41	2.48	2.38	2.55	2.25	2.54
4. Radio	1.97	2.08	1.95	1.85	2.07	1.83	2.07
5. Family/Friends/Relatives recommendations	3.71	3.77	3.75	3.59	3.93	3.56	3.63
6. Travel brochures (classical and electronic)	4.00	4.04	4.05	3.88	4.06	3.99	3.90
7. Travel Agencies (personal contact and advise)	3.73	3.71	3.71	3.78	3.78	3.77	3.58
8. Travel books, travel magazines	3.35	3.25	3.44	3.37	3.26	3.34	3.52
9. Movies	2.09	2.19	2.12	1.93	2.24	1.99	2.04
10. Books	2.32	2.38	2.33	2.23	2.42	2.15	2.47
11. Internet (websites, blogs, facebook etc.)	3.58	3.06	3.58	4.10	3.16	4.00	3.58

- The considerable influence of the travel books and magazines, mostly on the sample members who belong to the higher age, higher income and higher Technical education categories is a finding worthy of further consideration. Travel books and magazines belong, according to Gartner (2003) to the overt induced secondary information sources.

- The influence of the autonomous information sources has a moderate effect and is considered expected. The intense influence of Internet, in all its forms, as well as the influence of travel books and magazines, indicate the need for further analysis, with the implementation of factor analysis, in order to check new groups and possible shifts of the information sources in relation to the literature's categorization.

## 4.7 Implementation of factor analysis

### 4.7.1 Factor analysis

The question, through which the visitors evaluate the influential information sources in their decision to visit Corfu contains 11 variables.

The factorability of the data is determined by two ways. The Bartlett's test of Sphericity, which tests the null hypothesis that the data are not correlated (non collinear). In our case this hypothesis is rejected. The data are correlated and  $p=0,00$  ( $p<0,05$ ) Kaiser-Meyer-Olkin Measure of Sampling Adequacy (KMO) which tests the existence of common factors. Measured by the KMO statistics, sampling adequacy predicts if data are likely to factor well, based on correlation and partial correlation. If  $KMO \approx 1,0$  the data are factorable. In our case  $KMO = 0,871$  which is considered very satisfactory.

Table 4. Factor analysis – Rotated Component Matrix

SECONDARY INFORMATION SOURCES	1	2	3	4
1. Newspapers	<b>,867</b>	,122	,035	,079
2 TV / Radio commercials	<b>,856</b>	,163	,129	,011
3. Magazines	<b>,802</b>	,229	,200	,017
4. Radio	<b>,878</b>	,149	,049	,121
5. Family/Friends/Relatives recommendations	,131	,098	<b>,852</b>	-,071
6. Travel brochures (classical and electronic)	,039	<b>,821</b>	,198	,085
7. Travel Agencies (personal contact and advice)	,205	<b>,782</b>	-,067	-,057
8. Travel books, travel magazines	,253	,479	<b>,513</b>	,170
9. Movies	<b>,686</b>	-,006	,348	,281
10. Books	<b>,571</b>	-,152	,450	,347
11. Internet (websites, blogs, facebook etc.)	,145	,068	-,007	<b>,939</b>

### 4.7.2 Results – Findings from the Factor analysis (Principal Component Analysis)

Among the several approaches of factor analysis the method of Principal Component Analysis was chosen. The final solution gave 4 basic components. The percentage of variance explained is 74%. All the variables are represented satisfactorily with percentages (communalities) between 59% and 91%. Therefore, there is no reason to exclude any variable from the analysis.

For the final solution the Varimax method was chosen as the one that makes the explanation of the factors easier.

Therefore, the principal components that were extracted by the method described above and are presented in table 4, are the final solution. Specifically, the 4 common factors or components are described as follows:

- The first one is named "Autonomous information sources" and contains newspapers, TV/radio commercials, magazines, radio, movies, books.
- The second one is named "Induced information sources" and contains travel brochures (classical and electronic) and travel agencies (personal contact and advice).

- The third one is named “Organic information sources” and contains the usual family, friends, relatives recommendations. However, it shares a common variable with the overt induced information sources, the travel books and travel magazines.
- The fourth one is named “Internet” and contains only the various informational forms of the Internet.

In conclusion the factor analysis revealed the hidden aspects of the data structure, distinguishing 4 dimensions that were not directly measured. These 4 components will be named “influential promotional factors”. The above findings prove another time the reliability of the study since the basic sets of information sources, according to the literature, are identified.

However, at the same time some interesting shifts are detected. Specifically, “travel books” and “travel magazines” that, according to literature belonged to the overt induced sources of information, currently, in the eyes of the sample surveyed, have shifted to the organic information sources. In a similar way, Internet in its whole has become an independent and distinct factor, detached from the overt induced information sources. Nevertheless, and despite these interesting shifts, the foreign travel trade and its induced information sources remain the most influential promotional channel.

## 5. CONCLUSIONS – MARKETING AND MANAGEMENT IMPLICATIONS

The findings of this study can suggest several practices and implications. Specifically, the foreign tour operators and travel agencies staff, along with their promotional material proved to be the induced source with the greatest influence on the final buying decision. This, clearly, indicates that the authorities responsible for promoting destinations’ resources are forced to develop a relationship with this distribution channel and ensure that the messages transmitted coincide with the desired image of the place.

At the same time, they have to operate on the opposite direction trying to develop strategies that will reduce dependence from the foreign travel trade, such as selection and approach of new geographical target markets, segmentation research and formulation of the tourism product accordingly, exploitation of Internet’s power and effect and the creation of a strong brand identity.

With reference to the overt induced secondary information sources and especially those related to the travel books and magazines; it should be underlined that they are perceived as objective and tangent with the organic sources. As a result they have a considerable influence. This is probably due to the fact that they are published by independent publishers. This finding indicates that those responsible for developing the destination must seek and build relationships with the representatives of this promotional factor by providing them with truthful material and images compatible with the wants and desires of the target-markets.

The autonomous sources of information which have a moderate impact must not be overlooked. As Beerli and Martín (2004) support since the messages transmitted by autonomous sources are difficult to control, it is important for the destinations to collaborate more directly with the media and to keep track of the image which is being broadcast.

The findings of the study revealed the increasing impact of Internet. Despite the fact that Internet is an important source for travel information, consumer confidence for destinations engaged merely in Internet advertisement is low ( Cyr et al. 2005, Kwak, Fox and Zinkham 2002 ). This is something that must be taken into consideration by those responsible for developing a destination. Therefore, DMOs must plan effective online promotional strategies that can persuade virtual visitors to become loyal tourists.

On this issue Luna- Nevarez and Hyman (2012, p. 105) indicate that “DMO’s websites should be functional, simple, and aesthetically pleasing. As web site visitors’ main goal is to gather destination-related information, site design should minimize the time and effort (i.e. number of clicks) required for transactions. Sites should provide a snapshot of the destination and access to the most useful site-based features in the minimum number of screens. Innovative elements, such as real-time videos, news feeds, daily updates, mobile messages, social media integration, and e-newsletters, should boost site efficacy. Furthermore, user-generated content provided by social networking services should enhance website responsiveness, facilitate content personalization, and maximize the life time value of visitors”.

And they continue that “by exploring the characteristics of similar (within group) websites, DMO managers may identify the website design and features that evoke more positive reactions toward the depicted destination. Their exploration should focus on the amount of informative and commercial content, the variety and aesthetics of visual elements, and the efficiency of transactional features on the website. Aligning their

website's design and features with information preferred by visitors may require further research into visitors' needs and motives"

It should be noticed that tourists use online services increasingly and that the on line version of word-of-mouth is gaining a prominent place among other marketing tools. There is a variety of sites, forums, blogs etc. that allow tourists to share their travel experiences and relevant information, as well as offer judgement on all kinds of tourism services. Therefore, it would be wise for destination marketers to recognise these venues as a new approach for the marketing and promotion of a destination, particularly for destinations struggling with fierce competition. These visitor posts and reviews can add to the potential visitors' overall image of the destination, positively or negatively, and are likely to affect the purchase intentions. It appears that e-WOM plays an increasingly significant role as an information source and affects the image formation process.

However, the anonymity and almost free accessing and posting to online space make collusion a potential problem for both customers and marketers ( Pan, MacLaurin, Crotts, 2007 ). Basically, it is virtually impossible to control the content of the individual posts.

Because of the above, the personal, classical, word of mouth publicity is still considered to be the most believable, truthful communication channel. Because of the personal connection and contact involved, classical word of mouth is viewed as a more credible source of accurate consumer information than marketing information obtained through the mass media and even e-WOM.

This means that is vital that the messages transmitted in the income generating markets must be in accordance to and match the reality of the destination. In this context, the development of the image must be based on reality, otherwise the destination will not succeed in satisfying the tourists, which will in turn have a negative effect on the image that they will transmit through the powerful information source of word of mouth publicity.

In conclusion, the findings reveal the increasing importance and use of the Internet but, at the same time, reconfirm a general truth for all the established Mediterranean destinations. The unchanged influence of the foreign travel industry and tour operators on the tourists' decision making process. This finding means that the DMOs and the authorities of the Mediterranean countries have to try harder to influence their potential customers' purchase decision, through the use of an effective promotional mix.

From a practical perspective the study will help the DMOs and the public institutions responsible for sales management to project a suitable image of their markets by creating the best choice of communication mix.

From a marketing perspective the study revealed the constantly changing environment of the influential information sources. Changes, that could affect the literature's categorizations and demand new strategies and exploitation of the Internet potential. Above all, the findings clearly indicate that in order to implement effectively the above the product must always be developing in a sustainable and feasible way and in accordance to the wants and desires of the target market.

## 6. LIMITATIONS OF THE STUDY

The study is limited to one target market and to a specific structure of information sources, with Internet being measured as a whole. The findings and the rising of the Internet as a distinct information source demand further research in order to replicate, verify and expand the results.

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## WHY GREECE FAILED? A POLITICAL EXEGESIS

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### ABSTRACT

The root causes for the Greek crisis can be found only within the Greek political and institutional model of development and its model of governance. It seems that all the attempts for modernization and Europeanization not only failed to create a stable political and economic system in Greece but also solidified a mature clientelist political system as the main characteristic of the Greek polity. Thus, it is very difficult for the Greek political system to change considerably. The current demands made by Eurozone officials for austerity and a smaller, more efficient state apparatus are understandable but they amount to a demand that Greek political culture be dramatically changed in a very short time frame. This is not an easy task and is rather unlikely to be realized. This political dimension of the Greek financial crisis makes us worry about the future of the Greek state and the EU.

### KEYWORDS

Eurozone Crisis, Greece, European Economic Governance, Political Economy

### JEL CLASSIFICATION CODES

B52, FO2, F5

## 1. INTRODUCTION

The economic exegesis of the Greek crisis does not provide an adequate insight and explanatory basis of the situation of the country since it does not consider the political and institutional context within which this phenomenon has been taking place. The origin of the Greek crisis has a main political element that cannot be overlooked and it is largely different than the political cause of other European indebted countries. This is an important characteristic of the Greek crisis that we need not to forget which differentiates the Greek crisis with other paradigms of crisis within the Eurozone. Thus, the economic and fiscal performance of Greece cannot explain the severity of the Greek crisis.

We attempt to enrich existing framework of analysis with a series of governance indicators, being political and institutional variables which are very much related to the quality of political and institutional development in the country. We claim that economic convergence has not been followed by political and institutional convergence. In other words we argue that growth rates have been misleading and the Greek crisis should be expected. Thus, given that it is not an easy way to change the Greek political and institutional context, even if the current demands made by Eurozone officials for austerity and a smaller, more efficient state apparatus are understandable, it is not understandable how the Greek political culture can be dramatically changed in a very short time frame.

Using Greece and its crisis as an illustrative example we will show that the political and institutional development level is a critical component and a root cause for the Greek crisis. This skewed model was developed the last thirty years together with other political phenomena among others like, the statism, corruption, rent-seeking behaviour, political instability, populism, the blockage of reforms and parliamentary

instability. What in the first instance appears to be bad public financial practices and policy making is in essence a lack of the wider model of governance.

Even though, an economic solution of the problem can be agreed among the European political leaders, it will not solve the Greek problem. As it is observed from this paper, Greece is a real laggard in every indicator of governance within the European Union (EU). As these kinds of phenomena continue to be observed, the Greek crisis will remain. This makes us also pessimistic about the future of the Eurozone. The Greek crisis made evident that the Maastricht criteria are inadequate, and the EU has not developed practices that can support and affirm the political and institutional development and way of governance within its member states.

In order to reach our aim we will first provide the framework of our analysis. The overall economic performance of the Greek economy has not been an adequate variable to predict future developments. On the contrary, it has led to misleading assumptions about its performance and thus the Greek economy collapsed. This means that a more profound analysis is required, that being the scope and depth of political and institutional development of the country. We will then proceed with the analysis of seven indicators of the political and institutional development, these being statism, governance performance, the effect on the economy of powerful syndicates and interest groups, populism, Europeanization, corruption, political stability and parliamentary continuity. The assessment of the above indicators will demonstrate not only that the economic failures can be explained on the basis of poor political development performance but also that the Greek political culture cannot be changed as early as the European officials demand, and thus, the Greek crisis is likely to remain.

## 2. THE FRAMEWORK OF ANALYSIS

According to North (1990, p. 3) 'Institutions are the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction'. As Acemoglu and Robinson (2008, p. 1) believe '*institutions*, also very broadly construed, are the fundamental cause of economic growth and development differences across countries'. They also argue that it is possible to construct a context in which we can understand why and how institutions differ across countries, how they change, analyse the pitfalls of institutional reforms and see how they are linked with economic success. In this regard, Acemoglu and Robinson (2008, p. 25) conclude that

'The main determinants of cross-country differences in income per capita are differences in economic institutions. Though institutions often persist for long periods of time and have unintended consequences, differences in institutions across countries primarily reflect the outcome of different collective choices. Different collective choices reflect differences in political institutions and different distributions of political power. As a result, understanding underdevelopment implies understanding why different countries get stuck in political equilibria that result in bad economic institutions. Solving the problem of development entails understanding what instruments can be used to push a society from a bad to a good political equilibrium'.

A lot of scholars have also explained how the political and institutional variables and factors affect public economic function and, eventually, the government performance (Roubini & Sachs 1989; Grilli et al. 1991; Corsetti & Roubini 1993; Alesina & Perotti 1995). In this sense, there is a clear distinction among the increasing income and the improvement of the wider nexus of the political and institutional development (Kaufmann & Kraay, 2002). In this regard, the outcome of the economic crisis in Greece has revealed the fact that political institutions in the country have been far from being mature and suitable to achieve specific sustainable development targets and objectives.

After the collapse of the military dictatorship in 1974 two main political parties were created in Greece. When PASOK came into power in 1981, as Papas (2010) argues 'Greece experienced the rise of irresponsible populism, unrestrained patronage politics, and a powerful culture of ethnocentrism that worked against the country's full Europeanization. To the extent that Greek society had willingly accepted the terms of the contract offered to it by Papandreou, most of his successors in power felt no need to reverse them'. Thus, as Papas (2010) believes Papandreou in contrast to Karamanlis offered the Greek people a program with three main characteristics a) the imprudent economic expansion based on the manipulation of the state and its resources without providing for a stable tax basis able to fund such a policy b) the backing for a large and expansive, albeit not necessarily strong, state geared towards patronage politics c) Ethnocentric

nationalism, which was expressed either as a strong belief in the superiority of the Greek nation or as antipathy, let alone fear, towards other stronger nations. Under these conditions, the state and the public sector in the 1980's in Greece expanded enormously and even though one could argue that this expansion was necessitated in order to avoid job losses in non-competitive sectors, it cannot justify the overall assessment and performance of the public sector.

Over the next decade Europeanization and modernization have not been supported by the necessary institutions and the wider model of governance which was skewed and was negatively affected by many political phenomena like corruption and statism. In fact, Europeanization and modernization in Greece during the 1990's consolidate and legitimate the clientelist basis of the Greek polity. It is characteristic that almost all attempts for reforms the past thirty years failed. Both major political parties, alternating in power, have embraced the reforms and then proceeded to undermine them. There may be real modernizers within each party but there is no real modernizing party. By analyzing this framework it is likely to unveil and subsequently debunk a number of economic development myths, the following being the most prominent:

- Failed macroeconomic policies are the sole root cause of the Greek crisis;
- Political stability, policy continuity and sustainability has been prevailing in Greece and maintained by the Greek political leadership;
- A strategic vision for the country's development is being shared among the ruling parties.
- The Greek people's attitude and perceptions employ the top level shared vision and thus promote and practice competent economic and political development, averting interweaving and corruption.

These myths are related to political and institutional development attributes and governance such as political stability, long-term policy consistency and coherency even between successive cabinets from the same party, a shared strategic vision for the country, citizens that support, promote, and pursue infallibly economic and political prosperity in the long term. Significant attainment levels for these indicators are frequently taken for granted in developed economies, including the US, Japan, or the EU but not for Greece.

### **3. THE GREEK POLITICAL AND INSTITUTIONAL VULNERABILITIES**

Since the 1980's the Greeks created a skewed model of political, economic and institutional development, the Greek political leaders failed to change the aforementioned model and thus the whole system collapsed. In this respect, it can also explain the fact that all Greeks would like to become civil servants or work for the state in general. The Greeks created a skewed 'Leviathan' that failed to support them mainly in the three different stages of the 'socialization' process in the early 80's, the de-nationalization of the 90's and finally in the so-called 'modernization' period.

According to the rankings of the Lisbon Review, Greece in 2008 and 2010 is the 23<sup>rd</sup> country among the EU's countries (World Economic Forum, 2010). Greece is a real laggard in every field of economic, institutional and political development. The same result is also confirmed by the Centre for European Reform (2009). Because of the political and institutional instability, all the necessary reforms and the modernizations attempted during the last three decades in Greece failed.

#### *The development of statism during the 1980's and 1990's.*

When Greece joined the European Economic Community in 1981, its total GDP per head was 90,4% of the European (15) mean but unfortunately, this ratio decreased to 82,5% in 1985, and in 1990 74,2% (Alogoskoufis, 2009). During this period of economic underdevelopment in relation to the other European countries, the state expanded enormously; taken for example the law 1368/83 for the socialization of public enterprises and the nationalization of many public organizations, creating two major consequences. On the one hand there was the need to finance all these public activities and on the other the state expansion not only decreased the private initiatives for growth and the effectiveness of free market actions, but also changed the people's perception about its role.

This led to economic distortions that decreased the real GDP in the long run and at the same time increased the public deficits and the public debt permanently. Furthermore, it can be observed that from 1991-2007 in Greece we had nearly 65 privatizations (Rapanos, 2009) but in only 16 of these privatizations the state's participation after the privatization was below 50%. This means that the Greek state preferred

partial privatizations because it tried not to loose its sovereignty over the business. On the political and institutional level the development of statism led to the absolute failure of the stabilization and convergence programs because as Simitis (1989) believes, it was very difficult for many interest groups with specific economic and political interests to withdraw from their participation in the active redistributive schemes. Under these circumstances any attempt for a 'progressive modernization' of the political, economic and institutional development in Greece failed.

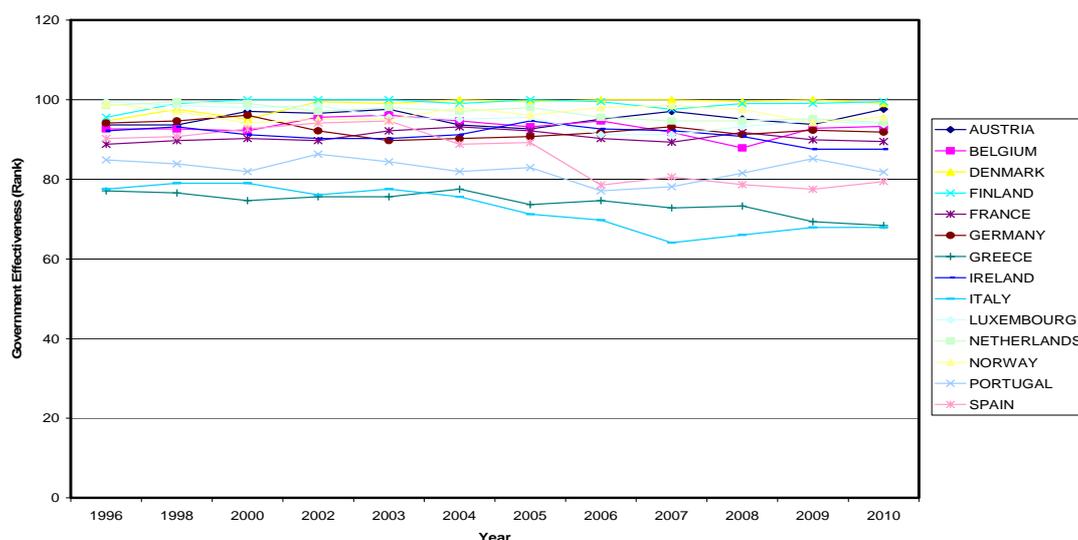
#### *Poor Governance Performance*

In Greece the wider system of governance really matters in order to approach the root causes for the crisis. First, this system which includes both formal and non-formal institutions' ideas and merits is very different from the European one. Even if we use the term 'structural congruence' (Katzenstein, 1997) or the term 'institutional fit' (Giuliani, 2003) the result is the same. Almost all the attempts for reforms, like for example the reform of the labour markets in 2000, failed because the governance hypothesis in Greece is inadequate. This 'institutional mess' (Tsebelis, 1995) was the main reason why the possibilities of political and economic reforms were limited during the last thirty years in Greece. As Featherstone (2005a) stresses the problem of governance still remains, even though he considers 1996 as a turning point for the Europeanization of the country, coinciding with Premier Simitis political agenda. This governance problem puts the nature of Greece's convergence with the EU in question. More precisely he points out that:

"Contemporary Greek politics are marked by tensions between pressures for reform and the structural constraints to their realization. The pressures combine those emanating from processes of Europeanisation (European Union agendas on economic reform, for example) and the domestic demand for 'modernization' (the agenda of former Premier Simitis). The two have been seen as synonymous in Greece. The resultant tensions have created a fundamental issue of governability: in a number of areas, Greece is '*une societe bloquee*'. There are systemic weaknesses deriving from the institutional capacity of the state, the regime of 'disjointed corporatism', and cultural practices of clientelism and 'rent-seeking'. These constrain agency and leadership strategies. The analysis places the recent Simitis project in an historical context and attempts to delineate patterns of change and continuity. The reform process has been asymmetrical and uncertain in character. The problem of governance remains and, in turn, it questions the nature of Greece's convergence with the EU." (Featherstone, 2005a, p. 223)

Secondly, the capacity for effective governance in Greece is limited. For example, Greece and Italy are the last European countries since 1996 in government effectiveness (Figure 1) which reflects perceptions of the quality of public services, the quality of civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Furthermore, according to the Sustainable Governance Indicators in 2011, Greece has the most disappointing performance in the capacity for reforms and in the management index, and it has only improved in a limited scope in the quality of democracy and policy performance in relation to the 31 countries in the quality of democracy and policy performance in relation with the 31 countries of OECD (Bertelsmann, 2011). The need for reforms is uncontested, but the implementation is inexistent.

**Figure 1. Government Effectiveness**



Source: (World Bank, 2012)

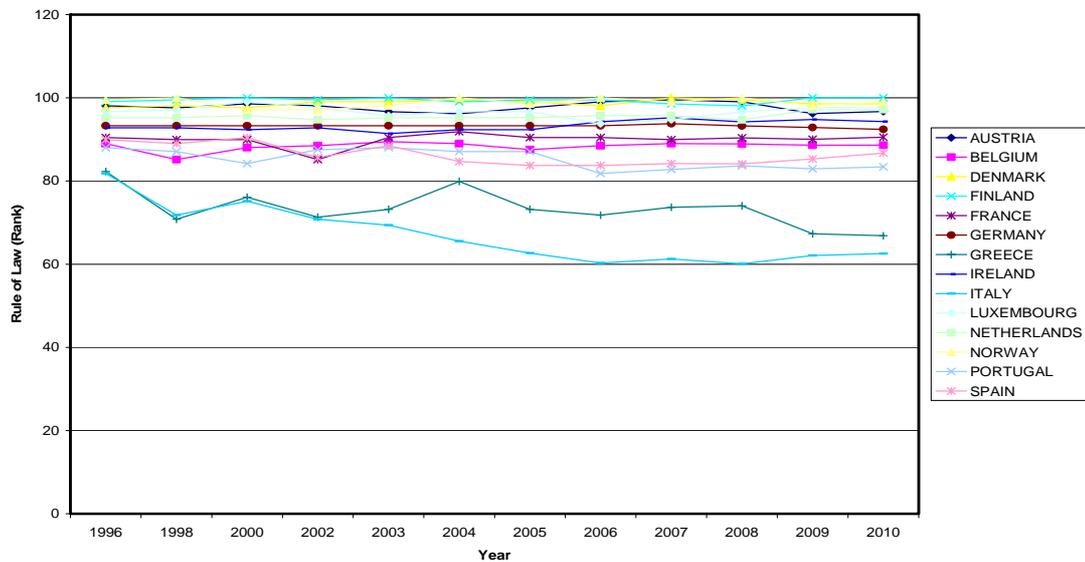
#### *Powerful Interest Groups and Syndicates*

According to Mitsopoulos & Pelagidis (2009a) the creation and existence of powerful and well-connected organized interest groups is a result of the high administrative burden and the poor governance. The most characteristic paradigm is the reaction to the so-called ‘Spraos Report’ which according to Featherstone, Kazamias and Papadimitriou (2001, p. 475) ‘revealed a deeply ingrained structural cleavage in Greek society on pension provision. Entrenched sectional interests sought to defend their accumulated privileges, whilst an inefficient and financially unsustainable system failed to meet the legitimate needs of other social groups’. Thus, in Greece many powerful interest groups can be identified that influence political and economic stability and development negatively. Mitsopoulos & Pelagidis (2009b, p. 399) describe very well how these organized groups act

‘these numerous rent-seeking groups curtail competition in the product and services markets, increase red tape and administrative burdens, and actively seek to establish opacity in all administrative and legal processes in order to form an environment in which they will be able to increase the rents they extract. At the same time, they actively strive to ensure that the rule of law fails to such an extent that the society will not be able to hold them accountable for their actions (...) salient aspects of the design of the Greek political system suggest why Greek politicians are unable to champion reforms and effectively confront the designs of these predatory interest groups’.

Indeed, in World Bank’s index for the rule of law, which reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, shows that Greece and Italy are the last European countries since 1996 (figure 2).

**Figure 2. Rule of Law**



Source: (World Bank, 2012 )

### Populism

Populism has also been addressed as one of the main characteristics of the Greek national system. This may have been one of the root causes for mismanagement (Tsakalotos, 1998). In this framework modernizing the Greek economy was very much connected with the function of a political system which was not ready to deal with a series of subsequent challenges. At first it can be observed during the 80's when the Greek economic policy failed from 1981-1985 and the macroeconomic performance of the state was disappointing. During this period it was the first time in Greece where the socialization process together with the development of statism created a skewed and continuously increasing nexus of governmental activities that developed the rent seeking actions and behaviours of the public managers.

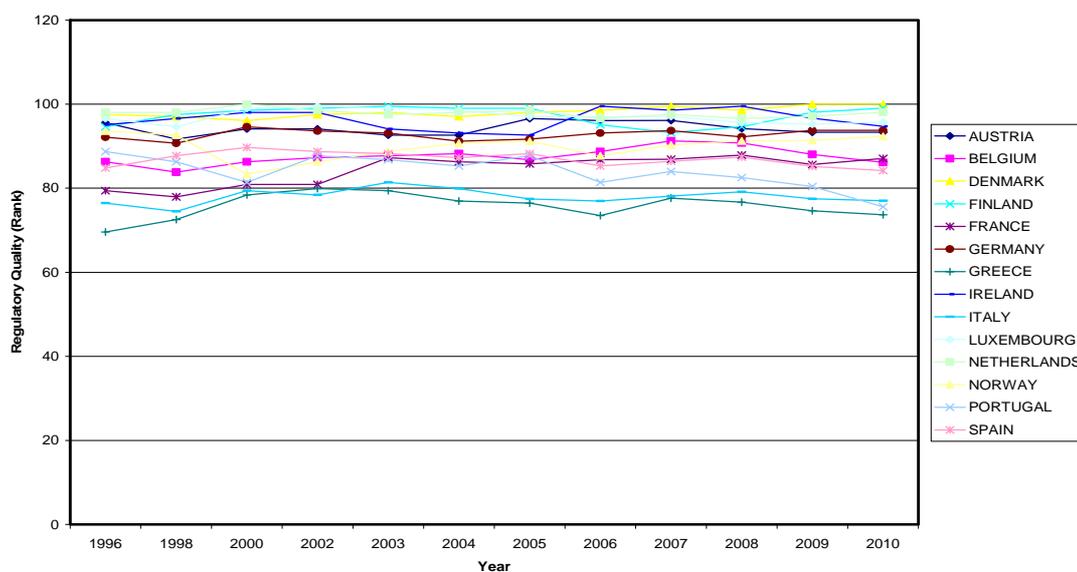
### Failed Europeanization

Even though, Greece joined the European Community earlier than other European countries, it remained a laggard regarding the typical and real adoption of the European rules and the European institutional context. In fact, all the Greek governments tried to adopt the *acquis communautaire* and the European directives but almost all the attempts either failed or their success was not fully effective. For example, the Open Method of Coordination (OMC) was not successfully applied by the Greek political authorities (Angelaki, 2007). As Borrás and Jacobsson (2004) believe the conditions for the policy transfer may be absent. This mismatch has also been successfully assessed in various cases especially when considering the relations between the state and specific social organised groups. One of these cases is the relation between the teachers and the teachers unions and the state modernisation policies as advocated by Simitis policy priorities and guidelines (Athanasiaides & Patramanis, 2002). Thus, it is now obvious that the Greek governments failed to develop a political and economic environment in which the OMC could be productive and successful (Featherstone, 2005b).

Moreover, it is interesting that in Greece the process of 'modernization' is identified with the Europeanization process (Featherstone, 2005a). However, even in this case the 'soft' and 'hard' European rules were never adopted effectively. Then implementation and practice of the new rules had many constraints that made the gap between modernisation and reality evident. During the last two decades, the European Union took legal action for non-compliance of Greece with the European directives in many cases. Three typical examples are the case of the accounting modernisation and the reorganisation of credit institutions, the case of infringements of EU environmental legislation, and the case of simplifying reporting requirements for mergers and divisions.

Furthermore, the low level of trust between the citizens and government policies has also increased the cost of applying those (Boix & Posner, 1998). Applying rational policies has also been even more difficult due to informal privileges for specific labour groups in the public sector. Thus, the real implementation of the European rules and the real modernization in Greece never came into effect from a cohesive institutional context in order to be incorporated as successfully as it was needed. It might seem a paradox but it seems that the Greek crisis revealed that Greece's real adoption of the European rules was minimal. Thus, it is not a paradox that in the regulatory quality rankings Greece is again the last country (Figure 3).

**Figure 3. Regulatory Quality**



Source: (World Bank, 2012)

### Corruption

The evolution of corruption in Greece is not as simple as it looks. In fact, it is related to the lack of a stable and developed civil society in the country (Makridimitris, 2006). Thus, as Kazakos (2010) argues the overgrown development of the state, the political centralization, and the client networks negatively affected the performance of the institutions and the corruption. As Graycar and Villa (2011, p. 437) believe, corruption's main consequence is 'a loss of governance capacity, and this is a greater and more prevalent loss than a monetary loss'. In this regard, Koutsoukis and Sklias (2005) state that among others, the most important factors that contributed to the phenomenon of corruption in Greece are a political system that favours clientelism, a complex legal framework that provides a scope for maneuvers as well as a political culture which provides space for such pathogenic behaviour.

According to the World Bank, control of corruption is the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. Figure 4 illustrates the control of corruption (rank) among the European countries. Again Greece belongs to the last two countries for the control of corruption in Europe. The same conclusion can also be affirmed from the Transparency International (2010) and from the World Economic Forum (2010). The control of corruption in Greece, it seems, is a very difficult task for politicians because corruption is related to the Greek cultural model of development. In this respect, the corruption level in Greece negatively affects the competitiveness as it increases the costs of production and at the same time creates a more skewed statism (World Bank, 2005).

**Figure 4. Control of Corruption**



Source: (World Bank, 2012)

*Political stability and parliamentary continuity*

The Greek political and parliamentary system is unstable. For example, it is believed that in Greece we had elections any time the political aristocracy wanted to reproduce its interests and its political power (Kazakos, 2010). As Alibizatos (2001) believes, the members of the Greek parliament make proposals without any viable strategy for institutional reform of the country.

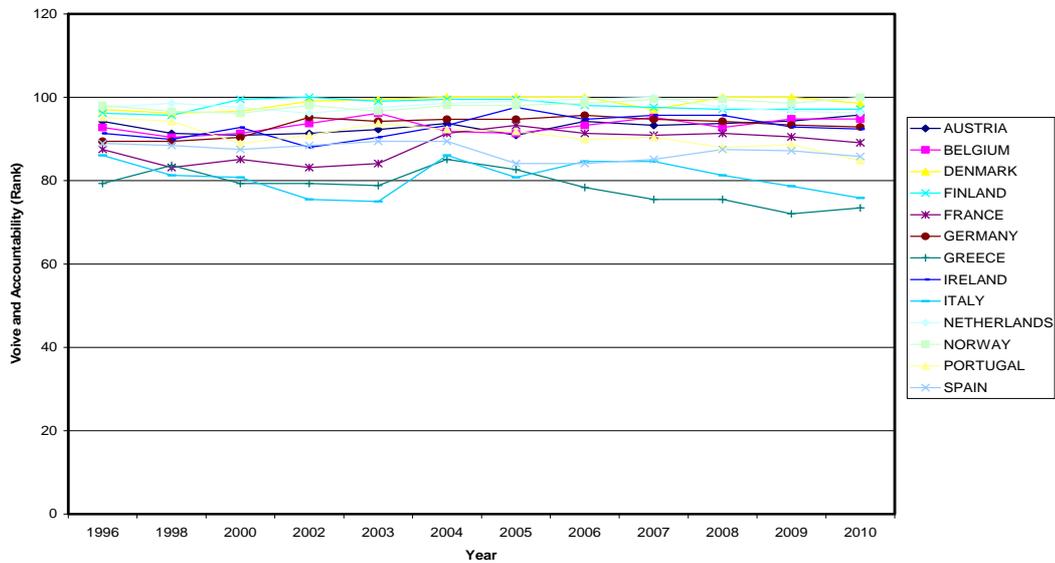
Policy sustainability and continuity in the country can also be an issue to be argued. Simitis' government case is also one that demonstrates the lack of policy continuity among governments of the same party in Greece (in this case the socialists' government). Simitis' pro-European modernization project, managerial and technocratic style has had very little similarities with his predecessor's political approaches. Convergence with the EU would not be considered as an easy path to be undertaken as it was the case with the A. Papandreou era. In Simitis era it was priority number one. As Featherstone (2005a, p. 228) mentions:

'Economic and social reform was to be placed alongside a fresh start politically. Simitis and his supporters advocated a greater separation of the 'party' from the 'state': a break with the incestuous 'rousfetti' politics or bureaucratic clientelism of the recent past. This was a condemnation of the Andreas Papandreou years.'

The same inconsistency can also be observed as a result of numerous ministerial reshuffles of a given government, which limits the possibilities to achieve specific policy goals within a given timeframe, not to say about institution-building potential. The dominating figure of Andreas Papandreou is a typical example of this situation. It is characteristic that only during the first four years of his governance (1981-1985) he used 70 members to serve his governments. In 1984 only, the country experienced 5 ministerial reshuffles and in 6 cases we experienced individual changes of ministers or vice ministers. During the second period of his governance (1985-1989) 105 people have participated in government ministerial positions. In the first 1,5 years of his second term 4 government reshuffles took place. We can also notice examples of government members who have seen the entrance and the exit of the government 12 times. In this regard, it can also be said that because the cabinet and sub-cabinet positions compared with other countries are more, the proportion of a governing party's parliamentary personnel who hold cabinet positions is very high. Consequently, cabinet positions are related to patronage and the mature clientelist political system. As Koutsoukis, Roukanas and Sklias (2012) state 'since democracy was restored in 1974, Greece should now have its 11th Government. However the truth is that Greece now has its 17th Government i.e. nearly 1.5 times as many governments as would have been expected with respect to full terms. Even without counting the coalition cabinets and taking into account only completed terms, the average term is 2.86 years'.

It is evident that policy consistency, efficiency and implementation are tasks almost impossible to be realized, under the said circumstances. Eventually, we argue that reforms were not followed and/or supported by an adequate institutional framework in order to materialise specific policies. It could be said that there are ‘cross-national factors rather than idiosyncratic characteristics that influence the inability and reluctance of a state to comply and conform respectively’ (Mbaye, 2001, p. 259). Under the aforementioned conditions scholars claim that the Greek politicians looks like a very well organized club which chooses its members and strengthens its protection (Kazakos, 2010). In this regard, Mitsopoulos and Pelagidis (2009b, p. 406) state ‘reform-minded politicians who threaten the status quo are easily removed from the political scene while politicians who cooperate with special interest groups are rewarded with long-lasting political careers and immunity from almost any unlawful act they may engage in’. Perhaps that is why, according to the World Bank’s rankings, Greece is one of the last two European countries in the voice and accountability index (Figure 5).

**Figure 5. Voice and Accountability**



Source: (World Bank, 2012)

As Featherstone (2005b, p. 747) stated for the pension reform in Greece ‘The constraints on the reform process question the nature of authority, legitimacy and participation in the Greek system. They pose major dilemmas for structural economic reforms motivated by different ideological perspectives –social, democratic or neoliberal- and they are unlikely to be overcome through a short-term project. The government is entrapped in a bargaining process that succumbs to stalemate unable to build effective alliances and to offer sufficient incentives’. This has a direct effect on the realization of the reforms. During the last thirty years almost all the great reforms failed, for example, the labour markets reforms (1998 and 2000), the insurance reforms in (2000 and 2008), and the reform for the closed professions has not been implemented yet, the reform of the National Health System (2000), the reform of the educational system, the environmental protection, the liberalization of energy markets and so on. Thus, figure 6, which shows the rank of political stability of the European countries since 1996, is again not a paradox anymore.

**Figure 6. Political Stability and Absence of Violence**



Source: (World Bank, 2012)

During the last thirty years in Greece, many political and institutional phenomena which are related to its model of governance and affect its economic performance prevail. The development of statism, populism, corruption, failed Europeanization, political instability, interest groups and the way of governance are highly related to the Greek model of political and institutional underdevelopment. In this regard, the root causes for the Greek crisis in the domestic area are mainly political rather than economic. The Greeks created a skewed ‘Leviathan’ that failed to support them. In this regard, it seems that all the attempts for modernization and Europeanization not only failed to create a stable political and economic system in Greece but also solidified a mature clientelist political system as the main characteristic of the Greek polity. Even if this mature clientelist political system is not analysed as a major cause of the Greek crisis, it is regarded as a major consequence of the above political and institutional underdevelopment in Greece. Thus, all the above political and institutional factors are also associated with a mature clientelist political system which was developed in Greece over the last thirty years and it is also responsible for the current crisis. In this regard, it could be said that the political elites used the borrowed new political institutions as new institutional resources by which they extended their patronage networks geographically and functionally. Even though, the political parties acknowledged the necessity of reforms and real modernization of the Greek society, at the same time undermined any effort for reforms and modernization. Thus, no real modernizing party can be found in Greece the last thirty years.

#### 4. CONCLUSION

The economic factors have contributed to the Greek financial crisis but they are not the root causes, which can be found only within the political and institutional model of development and the mode of governance. Thus, a series of political factors are highlighted as the key factors of this crisis. The development of statism, the failed Europeanization, the high level of corruption, the impact of syndicates and interest groups on the formation of economic policies, the skewed model of governance, populism and the unstable political and parliamentary regime are among the main factors that contributed to the crisis over the past 30 years.

The political causes of the Greek problem are not the same with other European highly indebted states. Thus, it is very difficult for the Greek political system to change considerably. The current demands made by

Eurozone officials for austerity and a smaller, more efficient state apparatus are understandable but they amount to a demand that Greek political culture be dramatically changed in a very short time frame. This it is not an easy task for the Greek and European officials and it seems unlikely to be realized.

It seems that all the attempts for modernization and Europeanization not only failed to create a stable political and economic system in Greece but also solidified a mature clientelistic political system as the main characteristic of the Greek polity. All the above political and institutional factors are also associated with a mature clientelistic political system which was developed in Greece over the last 30 years, and it is also responsible for the current crisis. From the beginning of its modern existence, borrowed 'modern' political institutions seem to have provided the political elites with additional political resources which in turn, made it possible to extend patronage networks geographically as well as functionally. Even though the political parties acknowledged the necessity of reforms and real modernization of the Greek society, at the same time they undermined any effort for reforms and modernization.

This political and institutional instability makes us worry about the future of the EU. On the one hand it is not clear whether the EU will change considerably during this crisis in order to anticipate such political element or if on the other it will question (itself) about future enlargements. Do the new member states really differ from Greece in this political dimension? The Greek economic crisis should be considered as a lesson for the future steps of the EU and the EMU, especially when the signs were clear and the Greek crisis was not unexpected and could have been prevented much earlier.

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# **EFFECTS UPON FOREIGN TRADE OF FYROM AFTER FREE TRADE AGREEMENT WITH EFTA COUNTRIES**

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## **ABSTRACT**

The FYROM economy is not traditionally connected and heavily dependent on the economic cooperation and trade exchange with the Iceland, Liechtenstein, Norway and Switzerland. FYROM had different customs, transport and transit procedures and completion of specific export/import documentation with above mentioned countries. This had a negative effect not only upon the total FYROM trade exchange, but it also hindered, slowed down and complicated the export-procedure to the EU-market. FYROM tried to fill in the gap in the foreign trade exchange of goods by signing bilateral free trade agreement with the above mentioned countries, actually EFTA members.

Therefore, two questions we are going to analyze in this paper:

Did the foreign trade increase between and FYROM and EFTA countries?

Did the export of FYROM increase towards EFTA countries?

## **KEYWORDS**

EFTA, FYROM, FTA, trade liberalization, trade exchange.

## **JEL CLASSIFICATION CODES**

F14, F15.

## **INTRODUCTION**

The Economic growth of FYROM during the last decade was the slowest in the region and much slower than the new member states of European Union. FYROM went towards the difficult times into world economic integration, despite several free trade agreements (FTAs), and the stability pact with EU. There were several reasons why it was so, including economical, political, internal and external. Basically the poor performance of the economy, it's weak productivity, the backward structure of the economy, the traditional structure of FYROM exports, the lack of implementation of international technical standards, as well as the lack of trademarks easy to recognize, are the main reasons for the weak competitiveness of FYROM exports not only on foreign markets, but on the domestic one as well (Kikerkova, 2006).

Regarding global competitiveness of FYROM on the Global Competitiveness Index 2012-2013 it is ranked 80<sup>th</sup> from 144 countries all over the world. Taking into consideration that Global Competitiveness Report stands out as one of the world's most comprehensive and respected assessment of countries' competitiveness, put FYROM from the 89<sup>th</sup> place in GCI 2008-2009 to the 80<sup>th</sup> on the last report, that is GCI 2012-2013. FYROM is best ranked on 2<sup>nd</sup> position for the Total tax rate and 4<sup>th</sup> position for the number of days in starting a business, and worst ranked on 136<sup>th</sup> for available airline seat km/week, 135<sup>th</sup> for brain drain and 133<sup>rd</sup> for reliance on professional management; buyer sophistication; firm-level technology absorption and nature of competitive advantage. According to the same source Turkey, Slovenia, Bulgaria, Montenegro, from the Balkans were ranked on higher positions than FYROM. The first one was Turkey ranked on the 43<sup>rd</sup> place, Slovenia on the 56<sup>th</sup> place, than Bulgaria 62<sup>nd</sup>, Montenegro 72<sup>nd</sup> from the total of 144 countries. It is important to mention that Croatia as a potential EU member country from 1<sup>st</sup> of July is ranked on 81<sup>st</sup> followed Bosnia and Herzegovina on 88<sup>th</sup>, Albania 89<sup>th</sup>, Serbia 95<sup>th</sup> and worst ranked from the region is Greece as a European Union member, ranked on 96<sup>th</sup> place.

In the last decade FYROM emphasized several FTAs, trade liberalization, regional integration and regulatory reform including business environment. Based on the study made by World Bank, FYROM's trade regime appears slightly more restrictive than that of an average Europe and Central Asia (ECA) country (6.8 percent), but more liberal than that of an average upper-middle-income country (9 percent). Similar to the majority of other countries in its comparator groups, FYROM is more protective of its agricultural goods (13.9 percent tariff) than of its non-agricultural goods (6.8 percent tariff).

Economic crises in 2009 effected FYROM by decrease in exports for 20%, and decrease in imports for 26% according to Central Bank of FYROM. Foreign trade increased in following years, in 2010 and much more in 2011, by increase in exports for 34% and increase in imports 29%. This also have a positive impact upon country's attractiveness for foreign direct investment. A lot of potential foreign investors are encouraged to make their investments in FYROM as they can see the way out for exportation of their final output.

FYROM authorities' believed that FTAs will have a better effect upon trade liberalization. Therefore, as a result CEFTA 2006 was created, that includes 7 countries; the FTAs with Turkey and Ukraine and the Stabilization and Association Agreement with EU member states, that includes 27 countries. In order to open the economy to more countries, FYROM signed FTA with EFTA countries. In total FTA with foreign trading partners are 40.

## **HALF OF CENTURY OF FREE TRADE UNDER EFTA**

EFTA is the world's oldest free trade area. It was launched in 1960 by the Stockholm Convention, primarily in response to the European Economic Community, which was established in 1957 (EFTA bulletin 2006). Seven European states signed the convention, Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom, to promote closer economic cooperation and free trade in Europe. In 1961 Finland becomes an associate member of EFTA. In 1970 Iceland becomes a member of EFTA.

Despite the fact that EFTA has considerably shrunk over the last decades — 6 of its 10 members have left the Association to join the European Union, United Kingdom and Denmark (1973), Portugal (1986), Austria, Finland and Sweden (1995), the organization has, for the remaining four members, lost nothing of its importance. The "New EFTA" as we know it today came into existence in 1995 with its present membership of Iceland, Liechtenstein, Norway and Switzerland. EFTA has, alongside the consolidation of the relations of its Member States with their main economic partner (the EU), led a successful 'third country' policy. It enables the current EFTA States to benefit from one of the largest networks of FTAs worldwide, covering fifty countries and territories across the globe.

FYROM signed agreement for free trade with EFTA states 5<sup>th</sup> of June 2000 and the agreement entered into force 1<sup>st</sup> May 2002.

Today, the liberalization of intra-EFTA trade relations has been achieved in most areas. In addition to updating the EFTA Convention, the Association has two substantive tasks: to assist the EFTA States in negotiating and maintaining FTAs (FTAs) with non-EU countries; and to assist Iceland, Liechtenstein and Norway in the operation and development of the Agreement on the European Economic Area (EEA). Work on the FTAs is carried out in EFTA's headquarters in Geneva, while EEA matters are managed in Brussels.

Within the framework of EFTA, its Member States have at present concluded FTAs with 50 countries and territories globally. Negotiations are ongoing with several large emerging economies and exploratory discussions are taking place with a number of other states on possible future agreements. At the same time, EFTA's Member States maintain their strong commitment to the multilateral rule-based trading system embodied by the World Trade Organization, and EFTA's FTAs are based on and seek to promote this system.

The EEA Agreement forms the legal basis for the economic cooperation between the three EEA EFTA States, Iceland, Liechtenstein and Norway, and the European Union. As parties to the EEA Agreement, they are full participants in the EU's Internal Market, which is based on the principle of free movement of goods, services, capital and persons, with uniform and homogeneous rules governing state aid and competition. Switzerland, though not a member of the EEA, benefits from its active observer status in the EEA EFTA structure.

In 2009, EFTA represented the world's eighth largest trader in merchandise goods and fifth largest trader in commercial services, with the EFTA States maintaining their positions as important markets for both outward and inward investment. Levels of GDP per capita were among the highest globally (This is EFTA, 2011).

The four EFTA States (Iceland, Liechtenstein, Norway and Switzerland) are world leaders in several sectors vital to the global economy. EFTA's two Alpine States, Liechtenstein and Switzerland are internationally renowned financial centers and hosts to major companies and multinationals.

The Swiss economy is based on high quality products commanding high prices in world markets. Switzerland is a world leader in pharmaceuticals, biotechnology, machinery, watchmaking, banking and insurance.

Liechtenstein, despite its small size and limited national resources, is highly industrialized and specialized in capital- and R&D-intensive high technology products, notably precision instruments.

EFTA's two Nordic States, Iceland and Norway stand out in fish production, the metals industry and maritime transport.

The Icelandic economy benefits from renewable natural resources, in particular rich fishing grounds and hydro and geothermal power. While still relying heavily on fishing and fish processing, the Icelandic economy has increasingly diversified into the aluminium and services industries over the last two decades.

Abundant natural resources also contribute significantly to Norway's economic growth, with activities focused on petroleum exploration and production, hydroelectric power and fisheries. Other important sectors include services, notably maritime transport, and oil related industries.

In 2011, the combined GDP of the EFTA States amounted to 843 billion euro, the 4<sup>th</sup> largest in the world. In terms of purchasing power, the EFTA States represented a sizeable market, ranking alongside countries with the highest GDP per capita in the world. Notwithstanding the global financial crisis, the EFTA States also benefited from low unemployment rates in comparison to other OECD countries. The EFTA economies are consistent strong performers with regard to competitiveness, according to the IMD World Competitiveness Scoreboard 2010 and the WEF Global Competitiveness Report 2010, and EFTA citizens maintain a high quality of life.

The EFTA States are traditionally dependent on, and open to, international trade. As a consequence, trade accounts for a significant share of their economic activity. In spite of their modest size, the EFTA States together constituted the world's eighth largest merchandise trader and fifth largest trader in commercial services in 2009, counting the European Union as one.

The EU27 is EFTA's main trading partner, accounting for 74.1% of EFTA's merchandise imports and 68.3% of its exports in 2009. EFTA is the EU's third largest trading partner, placing it before the Russian Federation and Japan. EFTA also ranked second in trade in services in 2008, after the United States and before China, the Russian Federation and Japan.

The EFTA States are key investors abroad, both in terms of direct investment and portfolio investment. Their combined stock of outward foreign direct investment (FDI) in 2009 amounted to USD 977 billion. The EFTA States also play host to a significant number of major multinational companies such as Nestlé, Novartis, Roche, Statoil, Credit Suisse, UBS and ABB.

## **EFTA FREE TRADE AGREEMENT WITH FYROM**

According to the Preamble of FTA between the EFTA states and the Republic of FYROM (Official Gazette of the Republic of FYROM, no.89), The Republic of Iceland, the Principality of Liechtenstein, the Kingdom of Norway, the Swiss Confederation (hereinafter called the EFTA states) and the Republic of FYROM recalling their intention to participate actively in the process of economic integration in Europe and expressing their preparedness to co-operate in seeking ways and means to strengthen the process. Desiring to create favorable conditions for the development and diversification of trade between them and for the promotion commercial and economic co-operation in areas of common interest on the basis of equality, mutual benefit, non-discrimination and international law, have decided, to establish a free trade area on 19 June 2000 in Zurich, Switzerland. In accordance with the Agreement, the transitional period is 10 years, starting from the date of entry into force that is on 1 May 2002.

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According to the Article 4, (Customs duties on imports and charges having equivalent effect), says that no new customs duties on imports or charges having equivalent effect shall be introduced in trade between the EFTA states and FYROM. All customs duties shall be abolished on imports and any charges having equivalent effect on products originating in an EFTA state or FYROM.

According to the Article 7 (Customs duties on imports and charges having equivalent effect), says that no new customs duties on exports or charges having equivalent effect shall be introduced in trade between the EFTA states and FYROM. All customs duties shall be abolished on exports and any charges having equivalent effect on products originating in an EFTA state or FYROM.

If an EFTA state finds that dumping is taking place in trade with FYROM, or if FYROM finds a dumping is taking place in trade with an EFTA state, the party concerned may take appropriate measures against this practice is laid down in article 19 (Procedure for the application of safeguard measures).

A party in serious balance of payments difficulties, may, in accordance with the conditions established under the GATT 1994 (WTO), adopt trade restrictive measures, which shall be of limited duration and non-discriminatory, and may not go beyond what is necessary to remedy the balance of payments situation (Balance of payments difficulties, Article 23).

Article 24 of the agreement allows implementation of safeguard measures and regulates their application. Article 27 explains the development and broadening of services and investments.

The implementation of this Agreement is supervised and administered by a Joint Committee, and each party is represented in the Joint Committee (The Joint Committee, article 29). The procedures of the Joint committee are explained in Article 30.

Procedures for dispute settlements are explained in Article 31.

FYROM will gradually abolish customs duties on imports or charges and vice versa, i.e. EFTA states, having equivalent effect on products originating from any of the EFTA states or FYROM, regarding fish products, in accordance with the following dynamics:

Upon entry into force of this Agreement:	90% of basic duty
One year after entry into force of this Agreement.	80% of basic duty
Two years after entry into force of this Agreement.	70% of basic duty
Three years after entry into force of this Agreement.	60% of basic duty
Four years after entry into force of this Agreement.	45% of basic duty
Five years after entry into force of this Agreement.	30% of basic duty
Six years after entry into force of this Agreement.	15% of basic duty
Seven years after entry into force of this Agreement.	0% of basic duty

On 8 May 2003 in Skopje, the Joint Committee FYROM-EFTA, held its first meeting, in which were ratified amendments and supplements of the free trade agreement between FYROM and EFTA countries. Changes have been made for the nomenclature appended to the International Convention on the Harmonized Commodity Description and Coding System (HS) of foodstuffs for animal feeding for the Annex I, which was replaced with new Annex I (Official Gazette of the R. of FYROM no.62).

Changes in nomenclature have been made in other Annexes, like: II, III and IV.

Amendment to protocol concerning processed agricultural products required adjustments in the HS structure of Tables II (Iceland), III (Liechtenstein, Switzerland), IV (Norway) and V (FYROM) to be replaced by Tables II, III, IV and V.

On November 28, 2008 in Geneva, the Joint Committee FYROM-EFTA, held its second meeting, in which were ratified amendments and supplements of the FTA between FYROM and EFTA countries. To Table 1 of Annex II, were added new products concerning fish and other marine products. To Protocol A, Article 2, for Processed Agricultural products were added texts, i.e. In order to take account of differences in the cost of the agricultural raw materials incorporated in the products, this Agreement does not preclude: the levying, upon import, of a duty; the application of measures adopted upon export. The fixed duties, levied upon import, shall be based on, but not exceed, the differences between the domestic price and the world market price of the agricultural raw materials incorporated into the products concerned. In Article 4 is added

text, such as, FYROM and the EFTA states shall inform each other of all changes in the treatment accorded to the European Community (Official Gazette of the R. of FYROM no.163).

The 4<sup>th</sup> decision of the Joint EFTA-FYROM committee, are amendments to protocol B, concerning the definition of the concept of “originating products” and methods of administrative cooperation. What includes Protocol B, except definition of the concept of “originating products” and methods of administrative co-operation?

It includes:

- Establishment and development of a Pan-Euro-Mediterranean cumulation system and the creation of a model protocol on rules of origin to be implemented in the Pan-Euro-Mediterranean cumulation zone.
- Inclusion of FYROM into the European cumulation network, in order to expand and promote production and trade in the European region.
- Recognizing that the extension of the EFTA-FYROM system of cumulation will improve the effectiveness of this Agreement, by allowing not only the use of materials originating in FYROM and the EFTA states but also the use of materials originating in the European Community, Turkey and the Faroe Islands, the countries or territories participating in the Euro-Mediterranean partnership based on the Barcelona Declaration, other than Turkey (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Syria, Tunisia, West bank and Gaza Strip), or the countries covered by the Stabilization and Association process, the EU’s policy for the Western Balkans (Albania, Bosnia and Herzegovina, Croatia, R. of FYROM, Montenegro, and Serbia, including Kosovo as defined in UN Security Council Resolution 1244/99)

The decision from the Joint Committee is that the text of Protocol B to be replaced by the text set out in the Annex.

Other important FYROM – Swiss economic agreements except FTA include:

- The bilateral investment promotion and protection agreement (in force since 06.05.1997)
- The bilateral double taxation avoidance convention (in force since 27.12.2000)
- The revised bilateral aviation agreement (in force since 01.03.2010)

Switzerland’s main export commodities remain pharmaceutical products, followed by textiles, footwear, electrical and mechanical machines. From FYROM, Switzerland mainly imports: textile and clothing, agricultural goods, as well as precious stones/metals and jewelry. Iceland and Norway from FYROM mainly import apparel or clothing accessories, while Iceland mainly exports to FYROM Fish products, and Norway chemical products.

The FTA encourages mutual investments as explained in article 27 from the agreement. The result is the investment in FYROM, actually in FENI Industries, in which the Swiss trading firm International Mineral Resources (IMR) is a majority shareholder and it remains one of the most important FYROM exporter. Through its connection with FENI Industries, Switzerland is an important trading platform for FYROM mineral exports throughout Europe. The Swiss company Duferco owns the steel company Makstil.

Several large Swiss companies are distributing their products in FYROM. The two main Swiss investments in FYROM are in the mining and steel sectors. A few other, small investments exist in the areas of transport, construction material, vegetables production and software services (Embassy of Switzerland in FYROM, 2011).

Switzerland takes the 6<sup>th</sup> largest Foreign Direct Investor in FYROM, with the total FDI amount of 200 million Euros.

It is a fact that for FYROM, EFTA countries are not the main trading partner. Comparing to other multilateral agreements that FYROM has signed, such as: CEFTA, the Stabilization and Association Agreement with European Union, as well as FTA with Turkey and Ukraine, the total amount of exchanged goods between FYROM and EFTA countries is less than 4%.

## METHODOLOGY

In this paper we used the data mainly from the source of the State statistical office of FYROM (SSOF) regarding the trade exchange of FYROM with the EFTA countries. From SSOF are analyzed in detail the export and import of FYROM with EFTA countries for the years before and after entry into force of FTA, actually for the 12 years period, 2000-2012.

## RESULTS

In **Table 1** we show the trade of goods for the period before the FTA between FYROM and EFTA countries, actually for the years from 2000 until 2002. After the FTA in May 2002, the export towards Switzerland as the main trading partner from EFTA countries started to decrease and on the other side exports of Switzerland towards FYROM market have been increasing gradually. Trade with other members of EFTA didn't have much impact on the foreign trade of FYROM.

**Table 1.** Trade exchanges of goods between FYROM and EFTA countries, for the period 2000-2002 ('000 US\$)

	<b>Export</b>	<b>Import</b>	<b>Trade deficit of FYROM</b>
	('000 US \$)	('000 US \$)	('000 US \$)
<b>2000</b>	35,739	29,904	5,835.00
<b>2001</b>	39,032	26,061	12,971.00
<b>2002</b>	27,721	30,854	-3,133.00

**Source:** External trade, State statistical office of FYROM

In **Table 2** are exposed the data of foreign trade of FYROM with EFTA countries from 2003 until 2012. In the last year, 2012, FYROM realized 33.7 million US\$ export towards EFTA countries, while import on the other side was almost five times higher, with the value of almost 152 million US\$.

Comparing the year last year with the year 2000 the exports of FYROM were a bit less than before the FTA with EFTA countries, actually in 2000 were 35.7 million US\$ and in 2012, 33.7 million US\$. From the year 2000 the exports of FYROM towards EFTA countries were decreasing gradually and they reached to the lowest level in 2004 with 6.4 million US\$. After this period the exports started to increase gradually. On the other side imports of commodities from EFTA countries have been increasing from year to year, except the year 2001 and 2003 when they slightly dropped, for about 1 million US\$ in each year.

As it can be seen in Table 2, for all the 12 years trading period, the trade balance of FYROM was in deficit with EFTA countries, except the first two years. The total deficit value for all this time reached almost 900 million US\$. Trade deficit increased rapidly in years 2007 and 2008, from 51.5 million US\$ in 2006 to 280 million US\$ in 2008. The trade balance gap started to diminish afterwards, from 280 million US\$ that was in 2008, to 82 million US\$ in 2010, actually 118 million US\$ in 2012.

**Table 2:** Trade exchanges of goods between FYROM and EFTA countries, for the period 2003-2012 ('000 US\$)

	<b>Export</b>	<b>Import</b>	<b>Trade deficit of FYROM</b>
	<b>('000 US \$)</b>	<b>('000 US \$)</b>	<b>('000 US \$)</b>
<b>2003</b>	19,533	29,036	-9,503.00
<b>2004</b>	6,850	37,735	-30,885.00
<b>2005</b>	7,869	65,370	-57,501.00
<b>2006</b>	10,576	62,033	-51,457.00
<b>2007</b>	11,556	118,342	-106,786.00
<b>2008</b>	17,556	297,535	-279,979.00
<b>2009</b>	19,148	127,779	-108,631.00
<b>2010</b>	20,521	102,543	-82,022.00
<b>2011</b>	32,288	177,127	-144,839.00
<b>2012</b>	33,716	151,908	-118,192.00
<b>Total</b>	<b>145,331</b>	<b>1,035,388</b>	<b>-890,057.00</b>

Source: External trade, State statistical office of FYROM

The **Table 3** shows that FYROM largest trading partner from EFTA countries is Switzerland, and smallest is Iceland. The trading gap between Switzerland and FYROM is huge, even though in year 2006 the gap was smaller, but it reached its peak in year 2008, with the trade deficit of 276 million US\$.

Trade exchange with the rest of the member-states is far less important, while with Iceland is insignificant. However, data presented confirm that the signing of the multilateral FTA has intensified the trade exchange of goods between FYROM and the countries from EFTA and certain increment is registered with all member-states, especially with Switzerland.

**Table 3:** Trade exchanges of goods between FYROM and EFTA countries, by each country, for the period 2000-2012 ('000 US\$)

<b>Country</b>	<b>Year</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Total</b>
<b>Switzerland</b>	Import	26,957	19,309	6,446	7,518	10,162	10,753	16,154	17,396	18,789	31,488	33,334	<b>269,307</b>
	Export	28,272	27,223	36,824	63,868	59,183	114,668	292,827	124,336	99,370	172,040	147,936	<b>1,216,506</b>
<b>Iceland</b>	Import	3	0	28	0	0	25	0	0	1	36	2	<b>95</b>
	Export	84	331	128	70	80	99	222	89	167	900	284	<b>2,907</b>
<b>Liechtenstein</b>	Import	661	0	314	284	127	46	0	0	56	0	14	<b>5,094</b>
	Export	938	720	364	596	222	273	166	88	20	22	71	<b>6,096</b>
<b>Norway</b>	Import	100	224	62	67	287	732	1,402	1,752	1,675	764	366	<b>7,609</b>
	Export	1,560	762	419	836	2,548	3,302	4,320	3,266	2,986	4,165	3,617	<b>30,718</b>

Source: External trade, State statistical office of FYROM

The data presented on table 4, show that FYROM trade exchange with Switzerland about 97.6%, from the total exchange of goods with all EFTA countries. FYROM in 2012 exported to Switzerland 18% and imported 79.7% from the total trade with EFTA countries. The remaining percentage was the trading with the other three members of EFTA. The second largest trading partner for FYROM is Norway, with about 2% from the total trade with EFTA countries.

**Table 4:** Trade exchanges of goods between FYROM and EFTA countries, by each country, for the year 2012 in percentage ('000 US\$)

Country		Year 2012	Trade in %	Total trade in %
<b>Switzerland</b>	Import	33,334	17.96	<b>97.65</b>
	Export	147,936	79.70	
<b>Iceland</b>	Import	2	0.00	<b>0.15</b>
	Export	284	0.15	
<b>Liechtenstein</b>	Import	14	0.01	<b>0.05</b>
	Export	71	0.04	
<b>Norway</b>	Import	366	0.20	<b>2.15</b>
	Export	3,617	1.95	
	<b>Total trade</b>	<b>185,624</b>	<b>100</b>	<b>100</b>

**Source:** External trade, State statistical office of FYROM

The data for the foreign trade of FYROM are also analyzed in detail for each member country of EFTA. For our analysis we used quantitative correlation between variables and regression analysis. Correlation between variables will help us to measure the level of relationship between the dependent variable (GDP of FYROM) and the independent variable (trade of FYROM with member countries of EFTA). The period analyzed is from 2003 until 2012, quarterly. The probability is 95%. Regression analysis is used to accurately measure the individual effect of the independent variable to the dependent.

<i>Regression Statistics</i>	
Multiple R	0.748486534
R Square	0.560232091
Adjusted R Square	0.548659251
Standard Error	339.2850796
Observations	40

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	5572596.111	5572596.111	48.40921547	2.80605E-08
Residual	38	4374345.88	115114.3653		
Total	39	9946941.991			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	1364.708207	105.0545974	12.9904663	1.49009E-15
Trade with EFTA	18.63460245	2.67828081	6.957673136	2.80605E-08

Regression Equation:

$$\text{GDP} = 1364.71 + 18.635 * \text{Net exports with EFTA countries}$$

From regression we found that by increase in one \$ of net exports, GDP will increase by 18.63\$. The relationship is strong (0.56) between two variables; it means that 56% of GDP of FYROM is realized from the trade with EFTA countries. F significance is good, less than 1% of the result is random. P-value is less than 0.05, meaning that our model is statistically valid. Since the F-statistics is 48, greater than critical value (4), we can conclude that the regression is statistically significant.

If we covert our variables to Log, we get the following results:

<i>Regression Statistics</i>	
Multiple R	0.872219985
R Square	0.760767702
Adj. R Square	0.754472115
Standard Error	0.058421636
Observations	40

ANOVA					
	<i>df</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	0.412442383	0.412442383	120.8414288	2.30563E-13
Residual	38	0.129697329	0.003413088		
Total	39	0.542139712			

	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>
Intercept	2.729980916	0.051296509	53.21962367	2.6738E-37
Trade with EFTA	0.382545627	0.034799685	10.99278986	2.30563E-13

Regression Equation:

$$\text{LogGDP} = 2.73 + 0.38 \text{Log Net exports with EFTA countries}$$

From regression we found that by increase in 1 percent of net exports, GDP will increase by 0.3825 percent. The relationship is strong (0.76) between two variables; it means that 76% of GDP of FYROM is realized from the trade with EFTA countries. F significance is good, less than 1% of the result is random. P-value is less than 0.05, meaning that our model is statistically valid. Since the F-statistics is 120, greater than critical value (4), we can conclude that the regression is statistically significant.

## CONCLUSION

Multilateral FTA with EFTA countries had an effect on increase of foreign exchange of goods in the Republic of FYROM.

FYROM was in trade surplus with Switzerland before the EFTA agreement, for two years, actually for year 2000 and 2001, and in the years after, actually from the data taken from State Statistical Office of FYROM was in trade deficit.

Analysis show that foreign trade of FYROM, actually exports towards EFTA countries, mainly to Switzerland as main trading partner, and Norway as a second important trading partner, started to increase in year 2004, from 6.5 million US \$ exports towards Switzerland in 2004, reached to 33.3 million US \$ in 2012; and exports from 60,000 US \$ towards Norway in year 2004, achieved to 1.7 million US \$ in year 2009, and dropped back to 366,000 USD\$ in 2012. Imports of FYROM from Switzerland, from 26.7 million US \$ in

year 2000 increased to 293 million US\$ in 2008, and then dropped to 148 million US\$ in 2012; and imports from Norway, from 1.3 million US\$ in year 2000, increased to 4.3 million US\$ in 2008, and then dropped to 3.6 million US\$ in 2012.

Taking into consideration that EFTA countries have the 4<sup>th</sup> largest GDP in the world, imports goods for all members of EFTA in 2010 were 198 billion US \$, shows that there is a huge potential for FYROM to increase its exports towards EFTA countries.

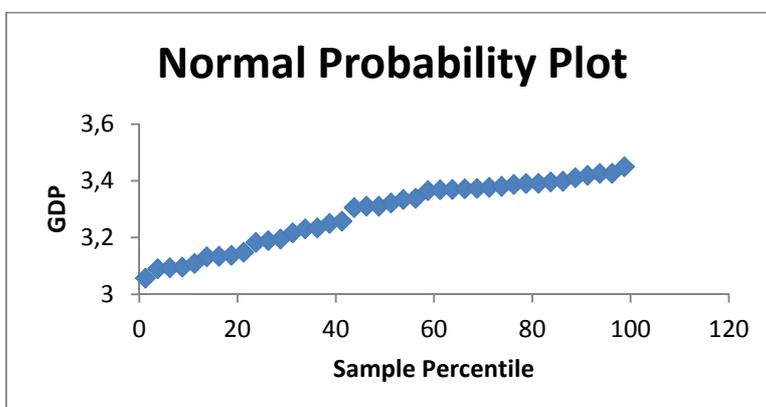
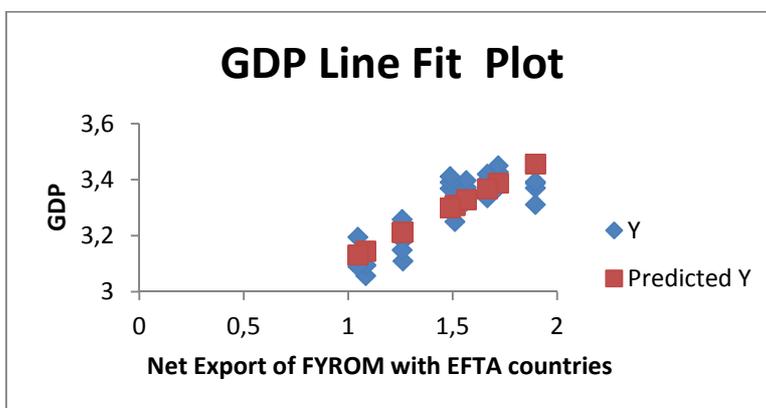
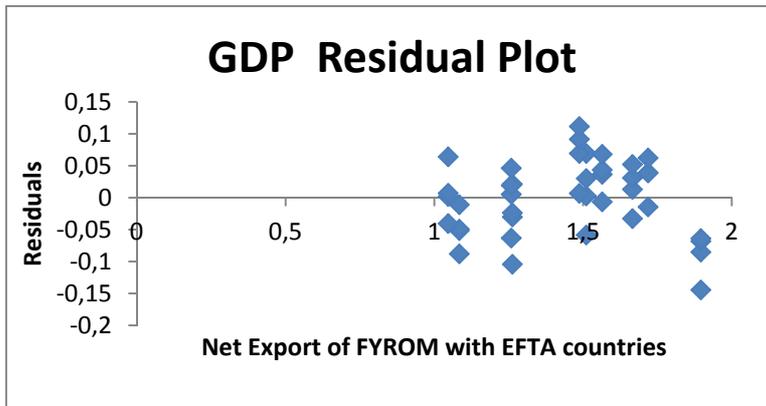
One of the reasons for the huge increase in the trade deficit of FYROM with EFTA countries, actually with Switzerland as the main trading partner, is the possibility of Swiss products, to use the low level of taxes that FYROM has, as well as few FTA with different countries, and to re-export them to the third countries.

FYROM authorities should work harder, to attract more foreign direct investments (FDI) from EFTA countries, taking into consideration that combined amount for FDI of EFTA countries in 2009 was 977 Billion US \$. Therefore, we strongly believe that FTA with EFTA is a given opportunity that should not be neglected.

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Annex of Regression in Log form



# CONSUMER ETHOCENTRISM: THE CASE OF GREEK STUDENTS

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## ABSTRACT

In the era of economic crisis in Greece the role of consumer ethnocentrism is substantial than ever before. This study is aiming to investigate the existence of consumer ethnocentrism in Greece as defined by Shimp and Sharma with a view to enhance understanding of consumer ethnocentrism in different circumstances, places and countries and its key role in universal trade and Greek trade and markets as well. Moreover the study is aiming to extend knowledge of cognitive processing of product' country of origin in this specify era of economic crisis in Greece. In addition the impact of the demographic factors such as gender, age, year of study, income and product' COO is also under study.

## KEYWORDS

Consumer, ethnocentrism, COO, students, PCA

## JEL CLASSIFICATION CODES

D12 - Consumer Economics: Empirical Analysis

## 1. INDRODUCTION

In the era of globalization substantial changes in the international markets and trade have been made. Ranjbarian et al. (2010) declared that the liberalization of trade policies has provided consumers with more foreign product choices than ever before in the whole world. According to Laroche et al. (2005) product's country of origin (COO) to consumers has significant strategic implications in relation to competitiveness for both companies involved in domestic and international businesses. Bar Tal (1997) argued that COO is strongly connected to ideology, beliefs and goals and imitates the fundamental stereotypes about each country. Furthermore COO has significant impact on consumers' evaluation of product quality and the intention to buy (Knight and Calantone, 2000). Therefore it is of major importance consumer attitudes in relation to consumer ethnocentric, consumer animosity and consumer infinity in marketing research.

Consumer ethnocentric is defined firstly by Summer (1906), as a tendency of superiority for their group and all things related to their own group.

In addition Shimp and Sharma (1987) defined consumer ethnocentrism as individuals beliefs held by American consumers about the appropriateness indeed morality, of purchasing foreign made products, products manufactured domestically were seen as being superior. Shimp and Sharma (1987) also added that for the perspective of ethnocentrism consumers, purchasing imported products have enormous consequences in the economy and employment. More specifically it hurts local and domestic economy, causes loss of jobs and is naturally unpatriotic; products from other countries (i.e., out groups) are objects of contempt to highly ethnocentric consumers.

Consumer ethnocentric can be seen from many points' of views: social-psychological, political, military, economic and demographic etc. In Strehlau† et al. (2012) (p. 103) Shankarmahesh (2006) identified four major factor categories that underlie ethnocentrism: social-psychological, political, economic and demographic.

This study is aiming to investigate the existence of consumer ethnocentrism in Greece as defined by Shimp and Sharma (1987) with a view to enhance understanding of consumer ethnocentrism in different circumstances, places and countries and its key role in universal trade and Greek trade and markets as well. Moreover the study is aiming to extend knowledge of cognitive processing of country of origin in this specify era of economic crisis in Greece. In addition the impact of the demographic factors such as age, gender, income and educational levels is also under study.

## 2. THEORETICAL FRAMEWORK

Research on consumer behavior of foreign products has made evidence that the country of origin is not only an important component used by consumers to evaluate foreign products but is an substantial construct in consumer decision making relative to buying foreign or domestic products or services Ben Mrad et al. (2011). Consumers' perceptions of the morality of buying foreign products, or consumer ethnocentric tendencies, are becoming an increasingly important issue for marketers in the global environment Herche (1992). Furthermore, Wanninayake et al. (2012) insisted that consumer ethnocentrism has become an important strategic tool used by domestic firms in the face of global competition. Ben Mrad et al. (2011) claimed that an important determinant in purchasing foreign versus domestic products is Consumer ethnocentrism. Additionally, Lantz and Loeb (1996) explored that the product' Country of Origin (COO) is more important than the brand name, price, and quality -in shaping attitudes towards the particular product. Chryssochoidis, et al. (2007) argued that ethnocentrism affects not only consumer beliefs, but also the way perceived quality of domestic and foreign products are evaluated, concluding in the of COO-effect.

Given the importance of country of origin to international marketers, the role of consumer ethnocentrism in decision making has been studied in many countries in order to understand their consumer attitudes toward purchasing foreign products or services Ben Mrad et al. (2011). Research on the concept of country of origin (Sharma, 2010, Ranjbarian et al., 2010; Chryssochoidis, et al., 2007), consumer ethnocentrism (Shimp and Sharma,1987; Good and Huddleston, 1995; Al-Sulaiti and Baker 1998; Shankarmahesh, 2006) and consumer animosity (Klein et al., 1998; Jung et al., 2002; Leong et al., 2008) are increasing, as these concepts are crucial in the understanding of consumer behavior in this globalized market (Poh-Chuin, Teo, 2011).

Consumer Ethnocentrism and Socio-demographic Variables were examined by many researchers (Good and Huddleston, 1995; Al-Sulaiti and Baker, 1998; Vida and Fairhurst, 1999). Regarding age, the dominant view is that the older will be more consumer ethnocentric than the younger. Regarding education, there is a near consensus that higher the education level lesser the consumer ethnocentrism.

Nijssen, Douglas and Bressers (2002) related consumer ethnocentrism to lack of knowledge. The results on income are split. Shimp and Sharma (1987) had found those in the lower socio-economic group are more ethnocentric than those in the higher up and this fact is strongly related to the fear of losing jobs to foreign competitors. As far as gender concerns, the dominant view is that women will be more consumers ethnocentric.

## 3. AIM OF THE STUDY

The purpose of the present study is twofold. The first objective is to evaluate the dimensionality of consumer ethnocentrism scale (CETSCALE) which was introduced by Shimp and Sharma (1987). The second objective is evaluating the impact of demographic factors on students purchase behavior.

## 4. THE INSTRUMENT

Shimp and Sharma developed a 17-item scale to evaluate consumers' ethnocentric tendencies and called it CETSCALE (Consumer Ethnocentric Tendencies SCALE). The scale seeks to clarify emotional dimension of purchasing imported goods regarding the implication to economic animosity, rationality and morality. More specifically, CETSCALE evaluates the degree to which consumers feel that the purchase of foreign products is unpatriotic and immoral because it threatens the domestic economy and cause the loss of jobs.

- q1. Greek people should always buy Greece-made products instead of imports.
- q2. Only those products that are unavailable in Greece should be imported.
- q3. Buy Greek-made products. Keeps Greece working.
- q4. Greek products, first, last, and foremost.
- q5. Purchasing foreign-made products is un-Creek.
- q6. It is not right to purchase foreign products, because it puts Greeks out of jobs.
- q7. A real Greek should always buy Greek-made products.
- q8. We should purchase products manufactured in Greece instead of letting other countries get rich off us.
- q9. It is always best to purchase Greek products.
- q10. There should be very little trading or purchasing of goods from other countries unless out of necessity.
- q11. Greeks should not buy foreign products, because this hurts Greek business and causes unemployment.
- q12. Curbs should be put on all imports.
- q13. It may cost me in the long-run but I prefer to support Greek products.

- q14. Foreigners should not be allowed to put their products on our markets.
- q15. Foreign products should be taxed heavily to reduce their entry into Greece.
- q16. We should buy from foreign countries only those products that we cannot obtain within our own country
- q17. Greek consumers who purchase products made in other countries are responsible for putting their fellow Greeks out of work.

## 5. SAMPLE-METHODOLOGY

The sample of population was 250 students from the Department of Educational and Social Policy of Macedonia University in Thessaloniki, Greece. 60 (24%) were males and 19 (76%) females. As regards students age 142 (56.8%) were 19 years old, 82 (32.8%) 20 years old, 6 (2.4%) 21 years old, 19 (7.6%) 22 years old, and one (0.4%) student did not mention his/ her age. As regards the year of studies, 142 (56.8%) were first year students, 80 (32%) second year, 5 (2%) third year, 19 (7.6%) fourth years students and finally 4 (1.6%) were before graduation. As regards students' family income 212 (84.4%) stated medium income, 29 (11.6%) moderate income, 8 (3.2%), and 1 (0.4%) did not give an answer. All the 250 students declare that they buy not only Greek but foreign products. As regards the product' COO, 130 students (52%) trust European products, 110 (44%) trust mostly American products and only 10 (4%) trust Asian products.

Principal Components Analysis (PCA), t-test and ANOVA tests were released in order the data to be analyzed.

## 6. RESULTS

*The Sample Sufficiency test and Sphericity Test:* The Sample Sufficiency test and Sphericity Test gives information about two hypotheses of factor analysis. From the test, we find out that sample sufficiency index KMO by Kaiser-Meyer-Olkin, which compares the sizes of the observed correlation coefficients to the sizes of the partial correlation coefficients for the sum of analysis variables is 0.882 and it is reliable because it overcomes 0.60 by far. In addition, supposition test of sphericity by the Bartlett test (Ho: All correlation coefficients are not quite far from zero) is rejected on a level of statistical significance  $p < .0005$ ,  $df=136$  for Approx. Chi-Square=1381,368. Consequently, the coefficients are not all zero, so that the second acceptance of factor analysis is satisfied. As a result, both acceptances for the conduct of factor analysis are satisfied and we can proceed to it.

*Scree plot graph:* The scree test produces (Figure 1) the following graph, which proceeds to a graphic representation of eigenvalues and guides us, to the determination of the number of the essential factorial axes.

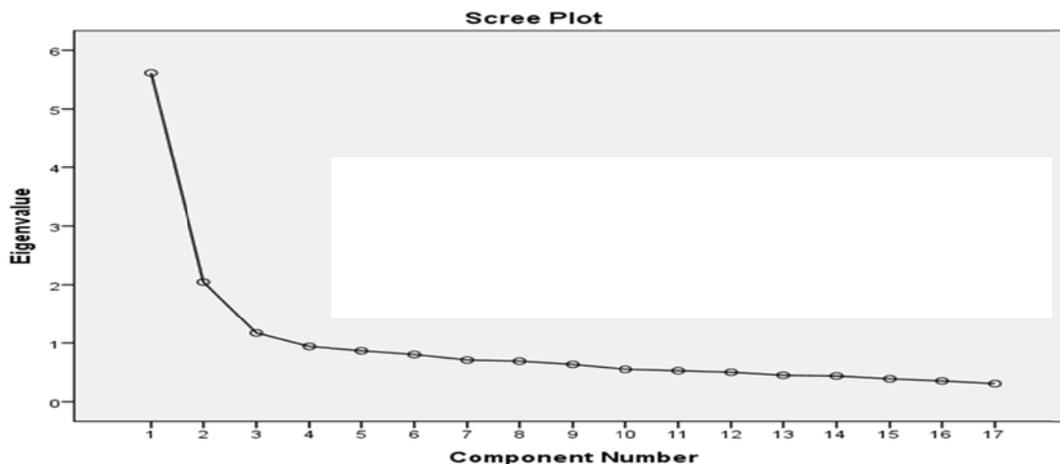


Figure 1

The above graph shows a distinct break up to the third factor, whereas, after the third one, it follows a linear part of the eigenvalue curve. So, taking under consideration eigenvalues, which are higher than 1 for the three factors (3,322, 2,864 and 2,646 for the 1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> respectively), we can decide that they satisfactorily interpret the data. In addition, the values of eigenvalues, which are higher than 1 for the three factors implies Convergent Validity of the instrument (Spector, 1992, Churchill, 1979) which refers to the extent to which items under each construct, are actually measuring the same construct.

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*Principal components analysis:* The study was conducted in March 2013. 250 valid questionnaires were collected. The size of sample is quite satisfactory as it is 15<sup>th</sup> times the sum of the questions of the questionnaire. The indicator of appropriateness of sample [KMO]=0.882>.60 showed that the data of sample were suitable for factorial analysis and Bartlett's test ( Bartlett's sign <.01) showed that the analysis in components makes sense. With this analysis, the data were grouped on the basis of each other cross-correlation with the aim of imprinting of those factors that describe completely enough the students' ethnocentric attitudes toward buying domestic and foreign products.

Based on analysis (Table 1), resulted 3 uncorrelated factors explain the 51.952% total inactivity of data and those are described separately afterwards. The factor of internal consequence (reliability) of Cronbach's *a* is statistically significant and equal to 0.863 for the total of questions and for that reason the scale of 17 questions was considered reliable with the significance of internal consequence. The factor of reliability (Cronbach's *a*) is statistically significant and equal to 0.800, 0.673 and 0.675, for the 1st, 2nd, 3rd, factorial axis respectively. Finally, from the prices of common factor variance (Communality) for each question we realise that most have value bigger than 0.50, fact that declares satisfactory quality of measurements from the sample - model of 3 factors - components. Moreover the model of 3 factors implies construct validity of the model (Cao and Dowlatshahi, 2005; Anastasiadou, 2006). In addition almost every item, load to it more than 0.50, fact that implies convergent validity.

More specifically, on the basis of students' attitudes, as it resulted from the factorial analysis, in first axis-factor F1 that it explains, with eigenvalue 3.322 which explains, following Varimax rotation, 19.542% of the total dispersion belong mainly the questions q17, q5, q14, q7, q11 and q6 and particularly with high loadings (0.774, 0.693, 0.664, 0.547, 0.523, 0.429) (Table 1).

The first factor sketches out the following students' opinions, which are: Greek consumers who purchase products made in other countries are responsible for putting their fellow Greeks out of work (q17) (M=3.02, sd=1.053), Purchasing foreign-made products is un-Creek (q5) (M=2.83, sd=0.993), Foreigners should not be allowed to put their products on our markets (q14) (M=2.91, sd=1.051), A real Greek should always buy Greek-made products (q7) (M=2.88, sd=1.037), Greeks should not buy foreign products, because this hurts Greek business and causes unemployment (q11) (M=3.28, sd=0.954), It is not right to purchase foreign products, because it puts Greeks out of jobs (q6) (M=3.09, sd=0.998). This factor highlights some median elements of xenophobia of animosity from economic point of view. More specifically, all the above items that lead to the construction of the first component have a mean value range 2.83 to 3.28 which shows that the level of Greece students' xenophobia attitudes is at a moderate level. The reliability of xenophobic factor is  $\alpha=0.800$  and is particularly satisfactory.

Using T-test for independent samples it is shown that there is significant difference between xenophobia elements of animosity and students' gender ( $t=3.748$ ,  $df=248$ ,  $p=0.001<0.05$ ).

In addition ANOVA test showed xenophobic factor is influenced by age ( $F=6,540$ ,  $p=0.001<0.05$ ) and the students' year of study ( $F=5.556$ ,  $p=0.001<0.05$ ) but is not influenced by income ( $F=2.796$ ,  $p=0.063>0.05$ ) and product' COO ( $F=1.961$ ,  $p=0.143>0.05$ ).

**Table 1.**Principal Component Analysis

Items- questions	Factors						Cronbach's alpha
	F1	F2	F3	Communality	M	sd	
q17: Greek consumers who purchase products made in other countries are responsible for putting their fellow Greeks out of work.	0.774			0.641	3.02	1.053	0.853
q5: Purchasing foreign-made products is un-Creek.	0.693			0.605	2.83	0.993	0.855
q14: Foreigners should not be allowed to put their products on our markets	0.664			0.460	2.91	1.051	0.859
q7: A real Greek should always buy Greek-made products.	0.547			0.574	2.88	1.037	0.847
q11: Greeks should not buy foreign products, because this hurts Greek business and causes unemployment.	0.523			0.482	3.28	0.954	0.850
q6: It is not right to purchase foreign products, because it puts Greeks out of jobs.	0.429			0.499	3.09	0.998	0.853
q9: It is always best to purchase Greek products.		0.789		0.679	3.47	1.018	0.852

(cont.)

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q10: There should be very little trading or purchasing of goods from other countries unless out of necessity.		0.741		0.580	3.32	0.940	0.856
q1: Greek people should always buy Greece-made products instead of imports.		0.671		0.593	3.09	1.312	0.870
q8: We should purchase products manufactured in Greece instead of letting other countries get rich off us.		0.602		0.578	3.47	1.049	0.850
q4: Greek products, first, last, and foremost.		0.536		0.522	3.60	0.932	0.854
q2: Only those products that are unavailable in Greece should be imported.		0.508		0.528	3.36	1.151	0.861
q13: It may cost me in the long-run but I prefer to support Greek products.			0.712	0.453	3.48	0.932	0.854
q16: We should buy from foreign countries only those products that we cannot obtain within our own country			0.696	0.533	3.64	0.955	0.857
q3: Buy Greek-made products. Keeps Greece working?			0.672	0.522	4.05	1.009	0.861
q15: Foreign products should be taxed heavily to reduce their entry into Greece.			0.524	0.496	3.12	0.972	0.857
q12: Curbs should be put on all imports			0.462	0.488	3.33	1.021	0.854
Eigenvalue	3.322	2.864	2.646				
Variance Explained %	19.542 %	16.84 %	15.56 %				
Cronbach's a	0.800	0.673	0.675				
Total Variance Explained %	51.952 %						
Total Reliability Cronbach's $\alpha$	0.863						
Kaiser-Meyer-Olkin Measure of Sampling Adequacy = 0.882							
Bartlett's Test of Sphericity: $\chi^2=1381.368$ , $df=136$ , $p=.000$							
<i>Extraction Method: Principal Component Analysis.</i>							

In second factor F2, with eigenvalue 2.864 which explains, following Varimax, 16.847% of total dispersion belong the questions q9, q10, q1, q8, q4, and q2 particularly with high loadings (0.789, 0.741, 0.671, 0.602, 0.536, 0.508) (Table 1). In factor F2 the attitudes on the moral role of ethnocentrism are presented. More specifically, they highlight the option that on one hand It is always best to purchase Greek products (q9) (M=3.47, sd=1.018) and there should be very little trading or purchasing of goods from other countries unless out of necessity (q10) (M=3.32, sd=0.940), and Greek people should always buy Greece-made products instead of imports (q1) (M=3.09, sd=1.312) and they should purchase products manufactured in Greece instead of letting other countries get rich off them (q8) (M=3.47, sd=1.049). Thus, students believe that Greek products, are first, last, and foremost (q4) (M=3.60, sd=0.932). In addition to that, students declare that they do believe that only those products that are unavailable in Greece should be imported (q2) (M=3.36, sd=1.151). This factor expresses the value of morality in respect of ethnocentrism. The reliability of this factor is  $\alpha=0.673$  and it is also very significant.

Using T-test for independent samples it is shown that there is no significant difference between morality elements and students' gender ( $t=-1.305$ ,  $df=248$ ,  $p=0.193>0.05$ ). In addition ANOVA test showed morality factor is influenced by age ( $F=2.749$ ,  $p=0.043<0.05$ ) and the students' year of study age ( $F=3.773$ ,  $p=0.005<0.05$ ). Morality factor is not influenced by income ( $F=1.029$ ,  $p=0.359>0.05$ ) and COO ( $F=1.364$ ,  $p=0.260>0.05$ ).

In third factor F3, with eigenvalue 2.646 which explains, following Varimax rotation, 15.563% of total dispersion belongs to the questions q13, q16, q3, q15 and q12 particularly with high loadings (0.712, 0.696, 0.672, 0.524, 0.462) (Table 1). In this factors it is notable that students express the conviction that it may cost them in the long-run but they prefer to support Greek products (q13) (M=3.48, sd=0.932). In addition the third factor is composed from the points of view of the participants in regard to their rationality to buy from foreign countries only those products that we cannot obtain within our own country (q16) (M=3.64, sd=0.955), their morality to buy Greek-made products. Keeps Greece working (q3) (M=4.05, sd=1.009). Their statements show that these students consider that foreign products should be taxed heavily to reduce their entry into Greece (q15) (M=3.12, sd=0.972), and Curbs should be put on all

imports (q12) (M=3.33, sd=1.021). This factor expresses rationality from the economic point of view. The reliability of the third factor is  $\alpha=0.675$  and is significant.

Using T-test for independent samples it is shown that there is significant difference between rationality elements and students' gender ( $t=-2.824$ ,  $df=248$ ,  $p=0.005<0.05$ ). Thus rationality factor is influenced by the students' gender. In addition, ANOVA test showed rationality factor is influenced by the students' age ( $F=3.234$ ,  $p=0.023<0.05$ ) and the students' year of study ( $F=3.868$ ,  $p=0.005<0.05$ ), but is not influenced by income ( $F=2.451$ ,  $p=0.088>0.05$ ), and product' COO ( $F=980$ ,  $p=0.377>0.05$ ).

## 7. CONCLUSION

This study has examined Greek students' consumption ethnocentrism, in this era of economic crisis, whereas ethnocentrism attitudes and behaviors could be enhance. It examined the construct of consumer ethnocentrism as well as the reliability and validity of the CETSCALEc. According to the empirical results given in above section, ethnocentric tendencies of Greece students' customers are represented in three psychological aspects such as xenophobia, morality and rationality. By the examination of the validity and reliability of the 17-item CETSCALEc verified that is an instrument useful for measuring Greek students' consumption attitudes.

Moreover the study on one hand showed that gender has a substantial role as regards to xenophobic and rationalism attitudes, age and students' year of studies influence xenophobic moralism and rationalism attitudes. On the other hand income and product' COO seem to have insignificant impact students' consumption behavior and ethnocentrism attitudes. Although this study has provided new insights into the dimensions of ethnocentric consumption behavior, future research will be needed to more fully understand these dimensions. A qualitative research can complement and enrich this quantitative research study and the same research may take place other sample graduate students as the comparison of two seems to have huge interest and create new discussions and implications.

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# **BANKING AND FINANCIAL ISSUES: FINANCIAL SYSTEM ANALYSIS AND ECONOMIC GROWTH**

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## **ABSTRACT**

Strategic Administration appears to be of the utmost importance in the Banking Management. In fact, Administrative and Operational Banking seems to serve Strategic Administration in the Banking Management. In addition, Banking Managerial tools and Processes are claimed to be based upon the basic decisions taken (Investment decision, Financing decision, Dividend Policy decision which are related to financial structure and to optimal structure too). On the other hand, cash flows as part of the Operational Banking are totally related to the corporate's profitability. It is an undeniable fact that cash flows contribute to transactions and thus their contribution to transactions and to Financial – Economic Growth and Prosperity in a State's Economy as a whole. The Money Market as well as the Capital Market need to be studied thoroughly. Market Efficiency appears to be of great interest, so it is quite necessary to study it too.

## **KEYWORDS**

Finance, Economic Development & Growth, Money Market, Capital Market.

## **JEL CLASSIFICATION CODES**

G10, G20, G21

## **1. INTRODUCTION**

As previously said, we are going to study the Money Market together with the Capital Market. Specifically speaking, the organizations having to do with deposits, have to be analyzed thoroughly.

With regard to an economic aspect, it appears to be of the utmost importance to study the organizations that operate on the basis of mutual financial agreements while on the other hand, we have to check which of these financial organizations are not included in the above categories.

In addition to the above analysis, we are going to study the fundamental operations of the financial system together with financial flows. Moreover, it is quite necessary to study the way in which the financial system influences Economic Development and Growth.

The four (4) basic operations of the financial system leading to normal operation of Economy, are:

1. The Payments Service; in general, the transferring of Money Amounts.
2. The Investment Service and the accumulation of Wealth.
3. The Activation of Primary and Secondary Financial Transactions.
4. The facilitation of Risk Management.

Moreover, emphasis has to be given to the efficiency of the market based on the EMH (Efficient Market Hypothesis) Analysis (Allocative Efficiency Operational Efficiency, Information Efficiency).

The aim of this paper is generalized in the following seven (7) issues:

1. To clearly state the categories of the financial organizations which accept deposits.
2. To place emphasis on the organizations that operate in the basis of mutual financial agreements.
3. To gain extra knowledge for the rest categories of the financial system.
4. To understand the operations of the financial system.
5. To study and thus to gain a high rate knowledge about financial flows and the procedure of financial and economic development and growth.

6. To study and understand the Market Efficiency.
7. To estimate the value of Market Efficiency..

## **2. THE PAYMENT SERVICE (THE TRANSFORMATION OF MONEY AMOUNTS)**

The Payment Service or the Transformation of Money Amounts is a common procedure with a number of types. For example, the imports service, the pensions payments as well as the payment of travel checks e.t.c. (Emery, Finnerty and Stowe 2007, Vasiliou 2005 a.).

## **3. THE ACCUMULATION OF WEALTH**

The Accumulation of Wealth is claimed to be a complex procedure of investment and allotment. The enterprises seem to invest their excessive amounts in many and different ways and types so that certain economic goals (which have to do with allotment, risk, duration e.t.c.), meet with success.

In fact, they would like to have the highest allotment with the lowest rate of risk. That has to do with their way of managing financial risk. Generally speaking the Modern Financial Theory deems necessary that the investor will only undertake the highest rate of risk if he/she is convinced that he/she will have the highest rates of allotment (Wistone 1995, Lynch 2000).

## **4. THE ACTIVATION OF PRIMARY AND SECONDARY FINANCIAL TRANSACTIONS**

The Financial System serves the procedure of transformation of excessive amounts of money from the corporations that meet with excessive amounts of money to the enterprises of shortfalls. While at the beginning of the transformation procedure, we are having the creation of new financial funds and thus we are having primary money transactions. After the new funds have been imprinted in a typical agreement (like a share, a bond, a certificate of deposit), they can be assigned from the original to the final new acceptor.

Their commercial handling is called a secondary transaction. It becomes clear that Primary Transactions are related to investment accumulation whereas on the other hand Secondary Transactions are related to issues like risk transportation and liquidity. Furthermore, during the realization of secondary transactions, more and more information does exist not only for the issuer of the original financial instruments but for the transactions' participants too (Penman 1999, Pike 1999, Ross 2010).

When a resources surplus is created, it is titled in a way (for example, a bank deposit). In such a way, business profits "give birth" to the corporate's excessive amounts of money which are deposited in a bank. As the case may be, savings are created by households (with excessive amounts of money).

Afterwards, the entrepreneur or the individual itself who happens to own excessive amounts of money can "hire" them to a corporate in shortage of money by buying its shares. In such a case, he or she will deny consuming today only if he/she is convinced that his/her prosperity in the future, in terms of time value of today, will be higher or equal to his/her today prosperity (with the assumption that he /she would have consumed all his excessive money). In other words, he / she would "lend" only if

$$U_f > U_t.$$

Assuming that  $U_t = C_t$  (prosperity of today is equal to consuming) then it becomes perfectly clear that  $U_f$  depends on time value of money as well as on investment allocation in relation to risk and duration of investment (Tirole 1998, Van Horne 2002).

Some times, we use for the same purpose either the term "Financial Instruments" or the term "Capital Assets". The Securitization of excessive resources leads to the creation of financial instruments. It is more than apparent that when financial instruments include investment and moreover they comprise of the constituent parts of financial structure, they are called Capital Assets. We can use either the one term or the other, having in mind that all Financial Instruments can be converted in Capital Assets.

## **5. RISK MANAGEMENT**

Risk Management has to do with financial instruments while it forms one of the basic operations of the Financial System. At this stage, the financial system is not concerned with the creation of new financial instruments. In fact, it is interested in the very important jobs of reduction and merchandising (thus, in transporting and delegation) of risk that many capital assets possess.

This kind of financial activity took place in the decades of 1970's and 1980's. The earlier financial activity of risk transportation and delegation took place with the accomplishment of trading under the supervision of assurance companies which about to undertake financial risks that other companies were denied to accept.

It is a fact that risk transportation takes the form of entry to the liabilities of the assurance company (in such a way the assurance company's financial obligations are against risks like the possibility of wreck or fire). On the other hand, there are more active types of risk trading like commodities futures. Their use is for the hedge against future alterations in commodity prices.

The corn producer (as a striking example), for the hedge against the possibility of future alterations in the price of his product, sells his products (usually, to a profiteer) and actually in a fixed price. In this way, the assurance companies' work is facilitated and thus made easy for them [the assurance companies hedge the corn producers against the possibility of price alteration of the specific product (primary task)] while they sell the commodities futures to other persons (a secondary task), delegating the undertaken risk.

Risk Management appears to be of great importance especially in the last three decades as a result of the demand increase of similar services and the increase of circulation of financial instruments which are offered for this purpose. Two (2) are the parameters that contribute to that:

- The exceptionally changing system of international exchange rate),
- The increasing internationalization of transactions.

On the the offering side, two (2) are the technological advancements that led to a great expand of Risk Management.

- The first one refers to the importance of the classification techniques and the presentation organization of the terms of financial derivatives in financial instruments (shares e.t.c.). In such a way, the choice procedure is facilitated as well as the procedure of the development of secondary transactions.
- The second one refers to the guarantee procedures having to do with the contract allotments. Based on these agreements, whoever buys a similar financial instrument he will face the specific terms of the specific agreement. Thus, the buyer is not obliged to consume resources in order to check how reliable the first publisher of each financial instrument derivative is. He/She only has to focus on the terms of the contract.

## **6. FINANCIAL FLOWS, ECONOMIC DEVELOPMENT AND GROWTH**

### **6.1 Financial Flows**

Financial Flows imprint pure transactions among the fundamental sectors of Economy. Financial Flows are registered in National Account Systems. In Greek Economy, similar systems are hold by the National Bank and by the National Accounts Service.

These sectors have to do with households, enterprises, governments, the financial sector itself and the rest of the world. The above accounts have to do with the changes in the present income and in spending. Thus, the creation of investments and savings is a fact.

When the putting aside is greater than investments, the sector is called a "surplus sector" whereas there is a "deficit sector" when investments exceed savings.

Households are, usually, a surplus sector while Enterprises belong to the deficit sector. The Financial Sector has a low contribution (positive or negative). Governments and the rest of the world have a low contribution too.

The households' financial funds take the form of savings, cash and their equivalents, e.t.c..

The Enterprises' Financial Assets are of two (2) main types: 1. Share Funds and 2. Lending.

The assets value that have been taken by enterprises as a percentage of around 30% of GDP in countries like Great Britain and U.S.A..

In addition, enterprises raise their lending funds in a multiplied ratio compared to their capital stock. Thus, the relation of liabilities to private capital fluctuates from 1-1,5 to 3 in Europe and 4 in Japan.

## 6.2 Economic Development and Growth

It is more than apparent that the relationship between Financial Structure and Growth was and still is an issue of great importance. More accurately, it is a fact that there is a positive interrelation between the two (2), but it is very difficult to clarify the proximate cause (s).

The starting point appears to be the relationship of investment alteration together with growth procedure. Furthermore, the kind of investments seems to seriously affect the production activity as a whole in the Economy and thus it also affects the Economy's and Society's Prosperity. It is beyond a doubt that primary financial transactions are positively related to the assets accumulation. In such a way the financial system does not have a basic role in the long-run assets accumulation taking into serious consideration the fact that the core of the procedure has its starting points in the creation of surplus resources.

It is widely acceptable that profitability development is reached by a system of tasks delegation. In addition, the existence of the financial system can lead to the effectiveness of the Economic system by:

1. The creativity of information.
2. Risk Management and Transformation.
3. The undertaking of the responsibility for the successful transformation of financial surplus to the economic units with financial shortages.

So, it is perfectly clear that the financial system develops the creation of excessive resources with a multiple effect to the rate of Growth.

Secondary transactions ensure that the original acceptors are characterized by financial liquidity: in other words the original acceptors have financial liquidity while on the other hand, secondary transactions facilitate the risk distribution. In such a way, risk undertaking is possible when talking about different investment plans and moreover we are talking about a fact that develops the possibilities of assets accumulation. In addition, secondary markets create information for the finance organizations investors which is a fact leading to the cost financial reduction of the economic units with financial shortage.

On the contrary, economic growth leads to financial development. Demand fluctuations and differentiations result in changes in the financial system.

### 6.2.1 Ways of Development of new Abilities and Skills in Financial Agreements

According to the previous analysis, it becomes more than apparent that the growth procedure is totally related to the development of new abilities in order to manage and control Financial Agreements.

These abilities are possible to be included in a more developed financial system (and not in a just developing one) (Lehman 1993, Keown, Martin, Petty and Scott2004).

So, it becomes perfectly clear that it is rather difficult for the financial systems to develop in underdeveloped economies because of the vicious circle of the underdeveloped rate. In addition, there is a great differentiation in financing between big and small enterprises. In fact, small businesses are difficult to ensure high rates of funding and moreover their ways of guaranteeing are limited too. For the above mentioned reasons, it is difficult for them to get access to long run assets, not to mention the fact that the funding of innovative corporates is based upon technological advancement and thus upon the profitability advancement of the System of Economy (venture capital companies together with financial administrators that are in the position of evaluating such entrepreneurial innovation systems).

The operation of the financial system has to do with agreements and how they are reached. In fact, it has to do with financial agreements between two or more participants who focus on the fact that these agreements meet with success while on the other hand, they are interested in the creation of high rating profits too (Eriotis 2005).

This kind of motivation is in other words a precondition in order that an economic unit takes part in a financial process. So, it becomes perfectly clear that profits made and allotments are fundamental elements of these agreements. It is a fact that the incoming participants accept some kind of operations while some other

times, they create new ones. Abilities and Information of financial participants appear to be of great importance; In fact, the above characteristics play an important role when it comes to the structure and modeling of the financial system (Xuemin 2006).

Whereas these agreements meet with success, in fact high rating allotment, it depends upon a lot of things: the objective of these agreements, the mechanisms included in the financial operation as a whole, the financial rules as well as the information taken.

The participants of the operation processes of the financial system who actually are the ones who take part in financial transactions, are the clients and sponsors, who, most of the times, are the parts of financial organizations ( Bol and Moers 2010).

The ones taking part in the financial system may be only financial managers with financial knowledge and skills who do not actually take part in the financial procedure with their own assets and funds. Such cases may be the financial institutions and the financial and economic consultants.

Households appear to be the most important participants in the financial system, providing with assets and funds. Moreover, the role of enterprises in the financial system seems to be of great importance too. Besides, the role of Governments in the financial system is of the same, great importance.

The participants in the financial system obtain their assets and funds within or out of the markets of the financial transactions.

Three (3) are the ways in which the participants in the financial system, invest their assets and funds (Frank, Brown and Brown 2000):

1. By buying shares through the market.
2. By lending or by investing through negotiations.
3. By lending or by investing in the financial organization itself.

Although that the participants' job seems to be the same for every one of them (actually to obtain and offer assets and funds), this job itself actually differentiates itself upon the choice of capability in general and more specifically the capability of managing financial agreements. The above mentioned capabilities and skills lead to the special structure and formation of their portfolios, their sources and their investment portfolios.

### **6.2.2 Operational Procedures of the Financial Mechanism**

The participants in the operational system of the financial mechanism reach financial agreements through interrelated procedures, so that there is a matching between demand and offer of financial instruments. These mechanisms are:

- The Markets.
- The operations held by Intermediary Organizations.
- The Intercorporate Integration.

So, a financial agreement can be reached either by terms of the market or by the procedure of bank valuation (Walter 2012, Jensen M.).

Deals and Agreements include some basic issues like the Effective Interest Rate which increases to higher rates because of the existence of risk and uncertainty; it is a fact that they are based upon the expiry dates, the guarantees and bonds, the currency used and other important variables.

The markets (like the capital market, the derivatives market, the bond market, the money market), operate for agreements that can be reached in countable terms. Thus, there could be agreements including risk and are related to liquitable issues like full contracts – there are similar contracts which include risk and allotment issues that can be measured exactly. In markets there are capital movements through special financial agreements that do not need to be further followed up; in other words, these kinds of agreements are completed at the time they are reached.

On the contrary, the Intermediary Organizations can reach agreements including risk as well as uncertainty. Furthermore, they can contribute to the development of economies of scale. The information of the Intermediary Organizations is only at their own disposal, most of the times. This could be changed by disclosing the terms of the reached agreement.

The Intercorporate Integration includes agreements with high rates of uncertainty; it is possible for them to continuously follow up the investment made while adjusting steps are possible to be taken.

According to the above, it becomes perfectly clear that only the Intermediary Organizations can handle agreements which include high rates of uncertainty and that offered service is charged with big amounts of money (Taowy, Tollington 2013).

In every mechanism of the Money Market are included agreements equivalent to its each organization's capabilities. For example, in the Capital Market transactions will take place only after the securitization and the standardization of allotments and risks. Besides, it is a fact that the cost of management and handling of such agreements is more and more developing while administrative costs and allotments are developing too.

According to Efficient Market Hypothesis (EMH), three (3) are the basic issues of Market Efficiency.

1. The Allocative Efficiency which is related to the way of distributing the financial resources between the competing acceptors.
2. The Operational Efficiency where transaction costs are of low rate.
3. The Information Efficiency as an important part of Market Efficiency. The Information Efficiency actually includes three (3) types of Efficiency:
  - Weak Efficient Market Hypothesis (WEMH).
  - Semi-Strong Efficient Market Hypothesis (SSEMH).
  - Strong Efficient Market Hypothesis (SEMH).

According to Weak Efficient Market Hypothesis (WEMH), it is assumed that there is not any plan related to bond prices.

According to Semi-Strong Efficient Market Hypothesis (SSEMH), it is assumed that there must not be any relation between the previous bond prices and the next movements of theirs and besides any information related to them must be publicly offered.

According to Strong Efficient Hypothesis (SEMH), it is assumed that no information must be taken into account when for the foresight of bond prices.

## 7. CONCLUSION

In this paper, we had the chance to analyse the basic operations of the Financial System (The Payments Service, The Investment Service, The Activation of Primary and Secondary Financial Transactions, The facilitation of Risk Management). Furthermore, we briefly, studied the three types of Market Efficiency (The Allocative Efficiency, The Operational Efficiency, The Information Efficiency) as well as the three types of Information Efficiency (Weak Efficient Market Hypothesis – WEMH, Semi-Strong Efficient Market Hypothesis SSEMH, Strong Efficient Market Hypothesis –SEMH).

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## ACKNOWLEDGEMENTS

- THANKS TO MY ACADEMIC BOSS - PROFESSOR, DR. VASILIOS TAMPAKAS.
- THANKS TO MY ACADEMIC TUTOR AND SUPERVISOR, PROFESSOR, DR. SIRIOPOULOS.
- THANKS TO THE TECHNOLOGICAL EDUCATIONAL INSTITUTE OF WESTERN GREECE: DEPARTMENTS OF ACCOUNTANCY, BUSINESS ADMINISTRATION, GREECE.
- THANKS TO HELLENIC OPEN UNIVERSITY, GREECE.
- THANKS TO UNIVERSITY OF PATRAS, GREECE.
- THANKS TO THE KAPODESTRIAN UNIVERSITY OF ATHENS, GREECE.
- THANKS TO UNIVERSITY OF MACEDONIA, GREECE.
- THANKS TO THE PRESIDENT OF THE SCIENTIFIC COMMITTEE OF EBEEC 2013, PROFESSOR, DR. ANASTASIOS KARASAVVOGLOU.
- THANKS TO THE PRESIDENT OF THE ORGANIZING COMMITTEE OF EBEEC 2013, DR. PERSEFONI POLYCHRONIDOU.
- THANKS TO THE ACADEMICS OF THE SCIENTIFIC COMMITTEE OF EBEEC 2013.
- THANKS TO THE ACADEMICS OF THE ORGANIZING COMMITTEE OF EBEEC 2013.
- THANKS TO THE ACADEMICS – PARTICIPANTS IN EBEEC 2013.
- THANKS TO THE MEMBER STAFF OF THE ORGANIZING COMMITTEE OF EBEEC 2013.
- THANKS TO THE PUBLIC UNIVERSITY OF INSTABUL (EBEEC 2013).

# **PATRIOTISM, NATIONALISM, NATIONAL IDENTITY IMMIGRATION AND REFUGEES IN GREECE IN THE ERA OF ECONOMIC CRISIS**

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## **ABSTRACT**

The present study validated patriotism, nationalism and national identity as determinants of attitudes towards Immigration and Refugees in Greece in the era of Economic Crisis, when the ethnocentrism emotion and behaviors may take new dimensions. The study evaluates 296 students' opinions in relation to the subject by the application of Principal Components Analysis. Findings reveal that intrinsic factors have a significant impact on students' behaviors towards refugees.

## **KEYWORDS**

Patriotism, nationalism, national identity, refugees

## **JEL CLASSIFICATION CODE**

R23 - Regional Migration; Regional Labour Markets; Population; Neighbourhood Characteristics

## **1. INTRODUCTION**

In the era of economic crisis in Greece, the country struggles to pay the debts; people suffer from severe measurements, taxes, poverty, and loss of jobs and unemployment. Both government and political parties are trying hard but the situation is extremely difficult. Every day unemployment rates are becoming bigger. In Greece not only many Greeks but immigrants and refugees, both legal and illegal, desperately search for a job, even permanently. In such situations not only ethnocentrism and racism but fascistic behaviors are developed. Racism toward immigrants and refugees can lead to low-breaking, human resources' exploitation, violence, and criminality.

Thus the present study examines students' patriotic, nationalistic, xenophobic and racist attitudes towards Immigration and Refugees in Greece in the era of Economic Crisis.

*Patriotism:* Many definition of patriotism been given so far. Others had defined patriotism as love for or devotion to one's country (Albarq and Nik Mat, 1995), others had defined patriotism, as a "healthy" love for individual's country (Bar-Tal. 1993; Bar-Tal and Staub, 1997; Kosterman and Feshbach, 1989) or as a "degree of love for and pride in one's nation" (Kosterman and Feshbach 1989) and others had defined patriotism as "strong feelings of attachment and loyalty to one's own country, but without corresponding hostility towards other nations" (Balabanis et al., 2001) and others as "a deeply felt affective attachment to the nation" (Conover and Feldman 1987).

*Nationalism:* Barber et al., (2010) argued that national identity is strongly related to nationalism in a sense of exclusionary or chauvinistic feelings of national superiority In addition Barber et al., (2010) argued that national identity is strongly related to patriotism in a sense of expressing positive feelings about an individual country.

*National identity:* Huddy (2001, 2003) defined national identity as "a subjective or internalized sense of belonging to the nation and measure it with questions that typically assess social identities".

## **2. AIM OF THE STUDY**

The present study aims to explore students' latent patriotic, ethnocentric, xenophobic attitudes towards refugees in the era of economic crisis. In particular, the paper reports the responses of 296 Greek students from the University of Macedonia in Greece.

### 3. THE INSTRUMENT PATRIOTISM AND NATIONALISM SCALE

Kosterman and Feshbach's (1989) developed a 12-item scale to evaluate attitudes toward patriotism (Patriotism and Nationalism Scale). All of the items made statements about patriotism and nationalism in regards to feelings about the flag, country pledge of allegiance or compatriots. The 12 items of Patriotism and Nationalism Scale were given answer scales that extended from 1 for total disagreement to 5 for absolute agreement (e.g. I love my country; I am proud to be a Greek) (Table 1).

### 4. THE INSTRUMENT NATIONAL IDENTITY SCALE

Huddy and Khatib (2007) had developed a measure of national attachment based on Social Identity Theory developed by Tajfel and Turner in 1979 (Tajfel and Turner, 1979). Huddy and Khatib (2007) argued that National Identity was assessed by four items. Thus 4-item National Identity scale was used in the present study (e.g. It is very important of being Greek to me; I see myself at a great extent as a typical Greek; The term Greek describes me at a great extent; When talking about Greeks I often say "we" instead of "they") (Table 2).

### 5. THE INSTRUMENT ATTITUDES TOWARDS IMMIGRATION AND REFUGEES

Anastasiadis (2013) developed a 10-item scale to evaluate attitudes toward Immigration and Refugees (Attitudes towards Immigration and Refugees Scale). All of the items made statements about Refugees in regards to unemployment, conflicts, rights etc.). The 10 items of Attitudes towards Immigration and Refugees Scale were given answer scales that extended from 1 for total disagreement to 5 for absolute agreement (e.g. Illegal Immigration and illegal Refugees should not come to Greece because this situation hurts Greek business and causes unemployment; Immigration and Refugees in Greece are responsible for the criminality and violence) (Table 3).

### 6. SAMPLE

The sample of population was 296 students from University of Macedonia. 120 (40.5%) were males and 176 (49.5%) females. As regards the year of studies, 232 (78.4%) were first year students, 30 (10.1%) second year, 5 (1.7%) third year, 25 (8.4%) fourth years students and finally 5 (1.4%) were before graduation.

### 7. RESULTS

B. *Principal components analysis of the Patriotism and Nationalism Scale:* KMO index for sample adequacy,  $KMO=0.871 > .60$ , showed that the data of sample were suitable for factor analysis and the Bartlett's Test of Sphericity (Bartlett's sign  $< .01$ ) showed that Principal Components Analysis (PCA) is appropriate.

Based on PCA analysis (Table 1), resulted 2 uncorrelated components/ factors explain the 50.458% total variance. Cronbach's  $\alpha$  is equal to 85.5% for the total Patriotism and Nationalism Scale. Cronbach's  $\alpha$  is statistically significant and equal to 85.2% and 83.1%, for the 1<sup>st</sup> and 2<sup>nd</sup> factorial axis respectively. Finally, communalities for each item are bigger than 0.50, fact that declares satisfactory quality of measurements from the sample - model of 2 factors.

The first factor, with eigenvalue 3.141 and 26.175% of the total variance, sketches out the following students' opinions, who claimed that they love their country (q1) ( $M=3.64$ ,  $SD=.936$ ), they are proud to be Greeks (q2) ( $M=3.56$ ,  $SD=1.216$ ), in a sense, they are emotionally attached to their country and affected by its actions (q3) ( $M=4.30$ ,  $SD=.773$ ), although at times they may not agree with the government, their commitment to the Greece always remains strong (q4) ( $M=3.57$ ,  $SD=.867$ ), they feel great pride in that land that is their Greece (q5) ( $M=3.69$ ,  $SD=.921$ ). This factor states quite strong patriotism attitudes as all the above 5 items that contributed to the construction of the factor have a mean value range 3.56 to 4.30 which shows that the level of Greece students' patriotism attitudes is at a quite high level. The item q3 with mean value ( $M=4.30$ ) shows a high level of patriotism level. The reliability of this factor is  $\alpha=0.852$  and it is also very significant.

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Using T-test for independent samples it is shown that there is no significant difference between strong patriotism elements and students' gender ( $t=1.082$ ,  $df=294$ ,  $p>0.05$ ). Thus Patriotism factor is not influenced by the students' gender. In addition ANOVA test showed Patriotism factor is not influenced by the students' year of study ( $F=1.940$ ,  $p>0.05$ ).

**Table 1.**Principal Component Analysis of the Patriotism and Nationalism Scale

Items- questions	Factors					
	F1	F2	Communality	M	SD	Cronbach's $\alpha$
q1: I love my country.	.772		.511	3.64	.936	.839
q2: I am proud to be a Greek.	.702		.514	3.56	1.216	.859
q3: In a sense, I am emotionally attached to my country and affected by its actions.	.644		.527	4.30	.773	.848
q4: Although at times I may not agree with the government, my commitment to the Greece always remains strong.	.636		.594	3.57	.867	.840
q5: I feel great pride in that land that is our Greece.	.593		.575	3.69	.927	.852
q8: The fact that I am Greek is an important part of my identity.		.758	.574	3.64	.992	.841
q6: It is that important for me serve my country.		.679	.617	3.29	1.015	.846
q7: When I see the Greek flag flying I feel great.		.646	.512	3.46	.994	.832
q11: It bothers me to see children made to pledge allegiance to the flag or sing the national anthem or otherwise induced to adopt such strong patriotic attitudes.		.632	.618	3.30	.898	.836
q10: In general, I have a lot of respect for the Greek people.		.520	.511	3.35	.946	.846
q9: It is constructive for one to develop an emotional attachment to his/her country.		.515	.600	3.34	1.099	.842
q12: The Greece is not really just an institution, big and powerful yes, but not just an institution.		.462	.502	2.81	.987	.856
Eigenvalue	3.141	2.914				
Variance Explained %	26.175%	24.283%				
Cronbach's $\alpha$	0.852	0.831				
Total Variance Explained %	50.458%					
Total Reliability Cronbach's $\alpha$	85.6%					
Kaiser-Meyer-Olkin Measure of Sampling Adequacy = 0.871 Bartlett's Test of Sphericity: $\chi^2=1189.863$ , $df=66$ , $p=0.000$						
Extraction Method: Principal Component Analysis. Rotation Method: Quartimax with Kaiser Normalization. a. Rotation converged in 2 iterations.						

The second factor, with eigenvalue 2.914 and 24.283% of the total variance, is constructed by the following students' opinions, who claimed that the fact that they are Greek is an important part of my identity (q8) (M=3.64, SD=.992). The second factor is also constructed by the following neutral students' opinions whether it is that important for them serve their country (q6) (M=3.29, SD=1.015), When they see the Greek flag flying they feel great (q7) (M=3.46, SD=.994), whether it bothers them to see children made to pledge allegiance to the flag or sing the national anthem or otherwise induced to adopt such strong patriotic attitudes (q11) (M=3.30, SD=.898) and they have a lot of respect for the Greek people (q10) (M=3.35, SD=0.946), whether it is constructive for one to develop an emotional attachment to his/her country (q9) (M=3.34, SD=1.099), and finally, whether the Greece is not really just an institution, big and powerful yes, but not just an institution (q12) (M=2.81, SD=.987).

This factor expresses mainly neutral nationality elements. More specifically, all the above items, but q8, that lead to the construction of the second component have a mean value range 2.81 to 3.46 which shows that the level of Greece students' nationalism attitudes is at a neutral level. The item q8 with mean value (M=3.64) show a high level of nationalism level. The reliability of this component/ factor is  $\alpha=.831$  and it is also very significant.

Using T-test for independent samples it is shown that there is significant difference between nationalism elements and students' gender ( $t=-2.789$ ,  $df=294$ ,  $p<0.05$ ). Thus Nationalism factor is influenced by the students' gender. In addition ANOVA test showed Nationalism factor is not influenced by the students' year of study ( $F=1.304$ ,  $p>0.05$ ).

B. *Principal components analysis of the National identity Scale*: KMO index for sample adequacy,  $KMO=0.758>.60$ , showed that the data of sample were suitable for factor analysis and the Bartlett's Test of Sphericity (Bartlett's sign  $<.01$ ) showed that Principal Components Analysis is appropriate.

Based on analysis (Table 2), resulted 1 factor explains the 46.256% total data inertia. The index of Cronbach's  $\alpha$  is statistically significant and equal to 74.2% for the total National identity Scale. The first factor, with eigenvalue 2.31 and 46.256% of the total variance, sketches out the following students' opinions, who claimed that it is very important of being Greek to them (q1) (M=3.81, SD=.866), they see themselves at a great extent as a typical Greek (q2) (M=3.52, SD=.964), at the same time the term Greek describes them at a great extent (q3) (M=3.63, SD=.951) and when talking about Greeks they often say "we" on instead of "they" (q4) (M=3.58, SD=.987). This factor states quite strong nationalistic attitudes in terms of national identity as all the above 4 items that contributed to the construction of the factor have a mean value range 3.52 to 3.81 which shows that the level of Greece students' national identity attitudes is at a quite high level. The item q1 with mean value (M=3.81) shows a high level of national identity level. The reliability of this factor is  $\alpha=.742$  and it is also very significant.

Using T-test for independent samples it is shown that there is significant difference between National identity elements and students' gender ( $t=-2.875$ ,  $df=294$ ,  $p<0.05$ ). Thus National identity factor is influenced by the students' gender. In addition ANOVA test showed nationality National identity factor is not influenced by the students' year of study ( $F=1.337$ ,  $p=0.248>0.05$ ).

**Table 2.**Principal Component Analysis of the National identity Scale

Items- questions	Factors				
	F1	Communality	M	SD	Cronbach's $\alpha$
q1: It is very important of being Greek to me.	.718	.516	3.81	.866	.720
q2: I see myself at a great extent as a typical Greek.	.702	.554	3.52	.964	.737
q3: The term Greek describes me at a great extent.	.695	.567	3.63	.951	.740
q4: When talking about Greeks I often say "we" on instead of "they".	.683	.593	3.58	.987	.732
Eigenvalue	2.31				
Total Variance Explained %	46.256%				
Total Reliability Cronbach's $\alpha$	74.2%				
Kaiser-Meyer-Olkin Measure of Sampling Adequacy = 0.758 Bartlett's Test of Sphericity: $\chi^2=236.975$ , $df=10$ , $p=0.000$					
Rotation Method: Quartimax with Kaiser Normalization Extraction Method: Principal Component Analysis. a. 1 components extracted.					

C. *Principal components analysis of the Immigration and Refugees Scale*: KMO index for sample adequacy,  $KMO=0.757>.60$ , showed that the data of sample were suitable for factor analysis and the Bartlett's Test of Sphericity (Bartlett's sign  $<.01$ ) showed that Principal Components Analysis is appropriate.

Based on PCA analysis (Table 1), resulted 2 uncorrelated components/ factors explain the 51.533% total variance. Cronbach's  $\alpha$  is equal to 84.7% for the total Immigration and Refugees Scale. Cronbach's  $\alpha$  is statistically significant and equal to 78.9% and 77.7%, for the 1<sup>st</sup> and 2<sup>nd</sup> factorial axis respectively. Finally, communalities for each item are bigger than 0.50, fact that declares satisfactory quality of measurements from the sample - model of 2 factors.

The first factor, with eigenvalue 2.848 and 25.893% of the total variance, sketches out the following students' opinions, who claimed that Immigration and Refugees in Greece puts Greeks out of jobs (q1) ( $M=3.74$ ,  $SD=.877$ ), Illegal Immigration and illegal Refugees should not come to Greece because this situation hurts Greek business and causes unemployment (q2) ( $M=3.69$ ,  $SD=.917$ ), Immigration and Refugees in Greece contribute the economic Crisis in Greece (q3) ( $M=3.51$ ,  $SD=1.005$ ), Immigration and Illegal Refugees in Greece causes many problems and conflicts to Greeks (q5) ( $M=3.58$ ,  $SD=.907$ ), Immigration and Refugees in Greece are responsible for the criminality and violence (q6) ( $M=3.64$ ,  $SD=.924$ ), Immigration and Refugees in Greece contribute the economic development in Greece (q4) ( $M=3.52$ ,  $SD=.974$ ). This factor states quite strong patriotic attitudes as all the above 6 items that contributed to the construction of the factor have a mean value range 3.51 to 3.74 which shows that the level of Greece students' ethnocentrism attitudes, is at a quite high level. The item q1 with mean value ( $M=3.74$ ) shows a high level of ethnocentrism. The reliability of this factor is  $\alpha=.789$  and it is also very significant.

Using T-test for independent samples it is shown that there is significant difference between strong ethnocentrism elements, negative ones, and students' gender ( $t=-1.765$ ,  $df=294$ ,  $p<0.05$ ). Thus, Ethnocentrism factor Negative factor toward Immigration and Refugees is not influenced by the students' gender. In addition ANOVA test showed Ethnocentrism factor or Negative factor toward Immigration and Refugees is influenced by the students' year of study ( $F=1.765$ ,  $p<0.05$ ).

**Table 3.**Principal Component Analysis of the Immigration and Refugees Scale

Items- questions	Factors					
	F1	F2	Comm unality	M	SD	Cronbach's a
q1: Immigration and Refugees in Greece puts Greeks out of jobs.	.697		.558	3.74	.877	.832
q2: Illegal Immigration and illegal Refugees should not come to Greece because this situation hurts Greek business and causes unemployment.	.676		.593	3.69	.917	.840
q3: Immigration and Refugees in Greece contribute the economic Crisis in Greece.	.618		.531	3.51	1.005	.835
q5: Immigration and Illegal Refugees in Greece causes many problems and conflicts to Greeks.	.602		.644	3.58	.907	.819
q6: Immigration and Refugees in Greece are responsible for the criminality and violence.	.580		.558	3.64	.924	.833
q4: Immigration and Refugees in Greece not contribute the economic development in Greece.	.567		.724	3.52	.974	.834
q10: Only legal Refugees should stay in Greece.		.729	.541	3.30	.895	.838
q9: Indigenous and Refugees in Greece must have equal working opportunities.		.716	.615	3.35	.946	.822
q7: Indigenous and Refugees in Greece must have equal rights.		.617	.571	3.56	.639	.847
q8: Indigenous and Refugees in Greece must have equal educational opportunities.		.531	.548	3.54	.632	.832

(cont.)

Eigenvalue	2.848	2.820				
Variance Explained %	25.893 %	25.641 %				
Cronbach's $\alpha$	0.789	0.777				
Total Variance Explained %	51.533 %					
Total Reliability Cronbach's $\alpha$	84.7%					
Kaiser-Meyer-Olkin Measure of Sampling Adequacy = 0.857 Bartlett's Test of Sphericity: $\chi^2=1054,242$ , $df=55$ , $p=0.000$						
Extraction Method: Principal Component Analysis. Rotation Method: Quartimax with Kaiser Normalization. a. Rotation converged in 2 iterations.						

The second factor, with eigenvalue 2.820 and 25.641% of the total variance, is constructed by q10, q9, q7, q8. More especial, the second factor is also constructed by the following neutral students' opinions whether only legal Refugees should stay in Greece (q10) (M=3.30, SD=0.895), and whether indigenous and Refugees in Greece must have equal working opportunities (q10) (M=3.35, SD=.946). In addition the second factor is constructed by the following students' opinions, who claimed that Indigenous and Refugees in Greece must have equal rights (q7) (M=3.56, SD=.639), and they must have equal educational opportunities (q8) (M=3.54, SD=.632). This factor states neutral attitudes because 2 items that contributed to the construction of the factor have a mean value range 3.30 to 3.35, which shows that the level of Greece students' attitudes towards refugees' rights is at a neutral level. The item q7 with mean value (M=3.56) and the item q8 with mean value (M=3.54) show a slightly level of racist. The reliability of this factor is  $\alpha=.777$  and it is also very significant.

Using T-test for independent samples it is shown that there is no significant difference between Refugees' rights factor and students' gender ( $t=2.315$ ,  $df=294$ ,  $p>0.05$ ). Thus Refugees' rights factor is not influenced by the students' gender. In addition ANOVA test showed Refugees' rights factor is not influenced by the students' year of study ( $F=1.408$ ,  $p>0.05$ ).

On the whole Principle components analysis relating to *Patriotism and Nationalism Scale* (Kosterman and Feshbach's 1989) formed into 2 factors. Factor 1, Patriotism factor, consisted of 5 items and Factor 2, Nationalism factor consisted of 7 items. High reliability values were found in both Patriotism and Nationalism factor (Cronbach's  $\alpha$  is .852 and .831 respectively), suggesting the suitability of both subscales.

Findings revealed that all the 4 items from National identity Scale suitably loaded into the same construct, which is Factor 3. Cronbach's  $\alpha$  indicated a significantly high reliability value (.742). However, the 10 item Immigration and Refugees Scale split into 2 factors and both of them indicated relatively high reliability value (.789 and .777 respectively). The six items were loaded as representatives of Ethnocentrism factor or Negative factor toward Immigration and Refugees, Factor F4, while the rest four items were loaded as representatives of Refugees' rights factor, Factor F5.

*Correlation analysis:* Pearson correlation analysis was conducted in order to examine the relationship between the overall attitudes and the seven constructs of Patriotism Nationalism and Ethnocentrism, suggested by the 3 PCA analyses (Tables 1, 2, 3).

The findings revealed that each aspect of the Patriotism, Nationalism, National Identity and Ethnocentrism attitudes have a positive correlation with aspects of Ethnocentrism factor or Negative factor toward Immigration and Refugees. The highest correlation coefficient ( $r=0.412$ ) was reported between Nationalism factor attitudes and the strong patriotism aspect and it was significant at 0.01 levels (2-tailed). National Identity attitudes have no a significant correlation with Refugees' rights aspects.

## 8. CONCLUSION

This study has examined Greek students' patriotism, nationalism and national identity as determinants of attitudes towards Immigration and Refugees in Greece in the era of Economic Crisis, when the ethnocentrism emotion and behaviors may take new dimensions. According to the empirical results given in above section, Greece students' patriotism attitudes, national identity attitudes, ethnocentrism attitudes, is at a quite high level and finally, nationalism attitudes and attitudes towards refugees' rights is mostly at a neutral level.

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# SOCIAL MEDIA ANALYSIS BASED ON ADVANTAGES AND THREATS

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## ABSTRACT

Information which is necessary for continuity of life is one of the main sources. To keep the firms' strategic power in their hands and continuity of daily life intense flow of information is needed. Internet is a technology that provides access to information uninterruptedly and data communication has changed along with development of the internet. Different platforms came into our life with rise of an interaction, in particular, known as Web 2.0. Users turned into people who produce and consume information on these social networking platforms that occurred transmission of information instantly. During this two-way flow, there are malicious users present a threat on the platforms in which contain many advantages for users who betray important issues such as personal information, brand images. Malicious users are caused information pollution on the internet that is an information pool along with applying various ways in order to achieve goals of pecuniary loss and intangible damages. Attacks occur from different parts of the world. When we take individuals and firms' losses as a result of these malicious attacks into account, the necessity of global intervention can be mentioned. In this study, the advantages of using social media and its threats were analyzed on the basis of social networks and policy recommendations in favor of all users are presented.

## KEYWORDS

Social Media, Social Networks, Threats, Information

## JEL CLASSIFICATION CODES

M15, L86

## 1. INTRODUCTION

In recent years, the variety of computer fields have increased, the use of information systems has been becoming widespread in support of many different functions in business community. At the same time the data volume we save and variety of data are also increasing. According to a survey made by IDC (2007) between the years of 2006-2011, spending of global IT will increase by % 6 annually. Employees at different departments and different levels use information system intensively. Over time, adding new functions to these systems and working on more effective and efficient usage of existing systems are required (Kuyumcuoğlu, M. and Başoğlu, A.N., 2008).

The strategic importance of the study are known on the basis of information systems in order to ensure customer loyalty, management effectiveness and sustainable economy.

A large portion of presence of an organization's information are covered by these systems. Some of the informations have become accessible from home and the street twenty-four hours. The dependence of computer technologies is increasing as a result of all of these (Kuyumcuoğlu, M. and Başoğlu, A.N., 2008).

Observed that the internet which has become a part of our lives with the presence of all resources and we use for many different purposes, is referenced more often in order to meet our information needs. Not only college students but also primary and secondary students benefit from internet to prepare their homework.

People can access the information in largest context, can use and share this information, is also socializing in visual and written environment in the internet world (Çevik E. et al., 2012). Technologies which facilitates the sharing of information are used intensively by individuals and firms day by day.

Sharing of knowledge is open to everyone, provide benefits in terms of development but brings different problems and dangers.

## 2. THE STRATEGIC VALUE OF INFORMATION

In the current era, speed and efficiency appears to be important factors in terms of meet customer expectations from organizations perspective. In order to fulfill these factors in a functional way, working with the support of information and information systems become necessary.

Today, the "information" concept is considered as an important resource by individuals and businesses. Very different assessments can be made about how to describe knowledge. Simplest meaning of knowledge, can be described as it is a strategic weapon to reach individuals and business's goals. While the concept of strategy evaluate events and facts, and define the objectives, it shows itself in a long term perspective and understanding of sustainable acquisition. Any business doesn't work with the logic let's establish the business today and let's close the business tomorrow, all of them are established as if to survive forever. In this posture, long-term perspective brings a "strategic" perspective (Çevik E. et al., 2012).

Concepts of information and knowledge can be mixed together. Headrick, analyzes the concept of information "knowledge and information overlap, as well as different concepts. Knowledge is a concept about the understanding of the human mind, ideas and data on the human mind: how to fix a flat tire, a good dentist's name, be able to speak French" (Headrick, D. R., 2002)

McClellan and Dorn went forward little more so asked the question Is information a science? and showed that the logic of information and the header agreed on with their following analysis.

"Practical information used in construction tools is different than the information based on an understanding of a naturel event. A set of instructions or an experience is required to change an auto tire instead of special technical knowledge or material resistance knowledge." (McClellan, J.E. and Dorn, H., 2006)

When defining the information and knowledge, data, information and header is important to know and position accurately. The data is the result of observations made on facts, and raw materials which knowledge is produced. Information can be expressed as processed and optimized data. The header is consist of the instructions, expertise and technical knowledge (know-how). The header is the result of integrating data and information with people's capabilities, training, know-how, experience, ideas, thoughts, intuiion, responsibilities and insticts in a specialized format (Gökçen, H., 2007).

When we analys the historical process at the sense of knowledge from a sociological perspective, revolution of information/knowledge technology appears in front of us. Castells mentioned that "information technology revolution make the analysis of blowing the spirit of liberal movements that flourished in the 1960s in semi-conscious manner (Castells, M., 2008)". Today, according to some sociologists, we live in an "information society" or "knowledge society" that is dominated by professional expert's scientific methods (Burke, P., 2008).

Information was also an important political problem: the question that should Data / Information be public or private? is based on that should be considered on a meta or social benefit (Burke, P., 2008).

### 2.1 The Role of Information Sharing on the Internet

As soon as New information technologies are spread, adopted by other cultures, other countries, various organizations, different purposes as soon as possible there was an explosion in all applications and uses that feeds the technological innovations, increases the speed, expanding the scale of technological change, adds variety of sources. As we know the internet was born in order to prevent the Soviet victory in a nuclear war or to prevent takedown of American communication networks in DARPA (legendary DARPA: US Defence Department Anvanced Research Projects Agency) in 1960s (Castells, M., 2008).

Began as a military project in the early 1960s, www (World Wide Web) founded by Tim Berners-Lee in 1989, and easy to use Internet technology around the world, in a day billions of information flow is provided to internet which affect the each types of user. This flow of information is not only with the creation of the new web pages, as well as social networking sites, blogs, comments on blog posts, video sharing sites and so on through various media such as Web 2.0.

Internet has become an essential part of human life with all resources and presence and is used for different purposes and the use of internet to meet the information needs is gradually increasing. Recently, "www" is referenced as a source in scientific publications and studies. Not only college students, but also primary and secondary level students benefit from internet to prepare their homework. Stated that people of different ages and different professions apply www for information and make a habit (Kurbanoglu, S., 2002 ). Not only individuals, but also firms seek information using www

resources. While they follow-up customers, competitors, innovations on the internet, they want to deliver information over the internet.

Individuals and companies can access the all kind of information in the broad context, they can share and use this information, they also gain ability to freely express themselves in written and visual environment in the internet world (Nakilcioğlu, İ.H., 2007). In this context Miniwats Marketing Group has revealed interesting research results.

According to the survey researched on December 31, 2011 and published in 2012 by Miniwatts Marketing Group, 2 billion people worldwide use the internet. This is equivalent to 32.7% of the world population (<http://www.internetworldstats.com/stats.htm>). In April 2012, According to the result of the survey Information Technology Usage in Households, 47.2% of households in Turkey have access to the internet from their home (<http://www.tuik.gov.tr/PreHaberBultenleri.do?id=10880>).

According to the survey Cisco 2008-2013 Visual Networking Index; the annual internet traffic will reach 667 exabytes in 2013. It will rise up to 13 exabytes in North America, 12.5 exabytes in Western Europe and 21 exabytes in Asia Pacific per month. To find the information within the exchange of intensive and quick information is similar to finding a needle in a haystack. Search engines are used to overcome this problem. Search engines can be seen as tools to achieve information in www world. 84% of researchers prefer to start a study on internet search engines and only 1% of researchers prefer to start a study on web pages of libraries.

In the period that www technology was used first, web pages were in the static structure and data entry was done by people who created the web page. This period is called Web 1.0. In Web 1.0, the information was provided only one way. The concept of Web 2.0 was first introduced in 2004 by O'Reilly Media. Web 2.0 emphasize on second-generation internet web based services as social networking sites, web-based free encyclopaedias and providing online tools (Bozkurt, A, 2009).

Difference between Web 2.0 and Web 1.0 is sharing information in two-way. Both visitors and site owners can share a variety of information on the same web page (Çevik E. et al., 2012). Table 1 shows technological differences between Web 2.0 and Web 1.0.

**Table 1:** Differences between Web 2.0 and Web 1.0 (Yalçın, Y. and Gençbüyür, H.İ., 2009)

WEB 1.0	WEB 2.0
Personal website built using Frontpage	myspace
Favourites folder	Netvibes
Encarta	wikipedia
streetmap or mapquest	google earth
Ofoto or Image Station	flickr
Home video	youtube
mp3.com	iTunes
Microsoft Office	Google Docs & Spreadsheets
Computer desktop	Goowy

Upon careful examination of the table, search engines with very large users, providing service of storing large amount of data and files on behalf of institutions, increase in the number of social networking sites and intense competition brought variety show us how big the internet is.

### 3. THE RISE OF SOCIAL NETWORKS AND SOCIAL MEDIA

Social networks are sort of web softwares which bring people together and provide communication and an exchange of information between them (Şendağ, S., 2008). Social networking tools have, until only quite recently, been limited in the main to interpersonal or socially driven, community-based virtual interaction. Chat rooms and community pages were the forerunners of today's online journals or 'blogs', where well over 63 million sites are currently being tracked in the 'blogosphere', according to the web site search tool for blogs, Technorati. And interactive knowledge bases or groups like the usergenerated and maintained entries of the Wikipedia encyclopedia have large and active subscriber bases (Yalçın, Y. and Gençbüyür, H.İ., 2009).

New concepts have entered our lives with Web 2.0 platforms. These concepts are social networks and social media which are frequently encountered in companies' marketing plans and daily conversation. Social media which is web software, is a social network because of mutual communication.

Social Media is a general name of any platform in which that individuals publish and share self-generated content. The biggest difference between Social media and classic media is a mutual communication. It is a platform that individuals can communicate with each other, institutions can communicate directly with individuals and can receive responds (Knights, M., 2007).

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For a better understanding of this platform, it is important to examine in a little more detail and also to know the features.

Key features of social media:

- It is a chain of internet applications based on sharing and discussion without limitation of time and space.
- Individuals publish self-produced content very easily on the internet and mobil platform.
- Individuals follow other users' content, comments.
- Individuals either can follow-up or can be followed-up in social media applications.
- Fundamental is not based on a specific communication rules, based on the logic of a friendly chat.
- Detailed inspection of contents are informal and observed that it can turn into a gossip chain over time. (<http://cagdasunal.com.tr/2012/03/06/en-populer-50-sosyal-medya-servisi-ve-kullanim-alanlari/>)

A nationally representative phone survey by the Pew Research Center's Internet & American Life Project finds that:

- 46% of adult internet users post original photos or videos online that they themselves have created. They are called creators.
- 41% of adult internet users take photos or videos that they have found online and repost them on sites designed for sharing images with many people. They are called curators. (<http://www.trendweek.com/sosyal-medya-nedir/>)

In 2011, according to Newspaper Association of America statistics, online advertising was up \$207 million industry-wide compared to 2010. Print advertising, though, was down \$2.1 billion. So the print losses were greater than the digital gains by 10 to 1 (Mavnacioglu, K., 2009).

While number of newspaper readers decrease, more than 78 million people are reading news online. About 39 million people are watching video online, 66 million people are reading a blog, 16 million people are creating a blog, so new authors within the last 5 years and new customer feedback create explosion (Pew, 2010 Transmitting: Laudon). Social network site Facebook has been visited 134 million times per month in the United States in 2010, 500 million times by visitors in the World. Enterprises use social networking tools to reach employees, customers and managers. There are many Facebook pages of Fortune 500 companies today (<http://www.pewinternet.org/Reports/2012/Online-Pictures.aspx>).

Facebook which is one of the best social network and uses Web 2.0, provides access to sending e-mail, applications, instant messaging, photos, music, and video sharing services as well as more than 300.000 applications developed by about a million different people. Users are able to shop on Amazon, browse OCLC's WorldCat catalog, provide connections between Facebook (eg, Slideshare) and other social networks (eg, LinkedIn), publish same messages to other social networks and Twitter (microblogs) at the same time without leaving the Facebook site. Number of active users on Facebook is more than 300 million (It was 140 milyon at the end of the 2008). In other words, the total number of Facebook users is as much as USA population which is the third largest country. Half of these users are using Facebook every day and spending six billion minutes (about four million days) in a day on Facebook (<http://stateofthemediamedia.org/2012/newspapers-building-digital-revenues-proves-painfully-slow/?src=pre-section> ).

According to social media and internet statistics published in September 2012, the obtained results are summarized below.

- 27% of small and 34% of medium businesses are using social media for business (+10% Year on Year)
- Social media users who receive excellent customer service from brands spend on average 21% more than non-social customers
- There are over 10 million social mentions of the Fortune 100 each month
- 87% of the Fortune 100 now use social media
- 75% of the Fortune 100 are on Facebook
- Each corporate YouTube Channel averages 2million views
- Fortune 100 Companies are creative multiple accounts per platform / per region
- 50% of Fortune 100 Companies have a Google+ Account
- 25% have a Pinterest Account
- 40% of young workers rate access to social media at work *abovereceiving* a higher salary
- 65% of corporate marketers use social media to gain market intelligence
- 77% of B2C companies have acquired customers from Facebook vs 42% of B2B (Laudon, K. C. and Laudon, J., 2011)

When we look at the ranking of the most popular social media tools, Twitter comes first with 65% among the top 100 companies. Facebook follow it with 54%, Youtube follow it with 50% and corporate blogs follow it with 33% ([http://www.businessweek.com/technology/content/jan2009/tc20090121\\_557202.htm](http://www.businessweek.com/technology/content/jan2009/tc20090121_557202.htm)).

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One of the reasons why companies choose social media as a communication tool is the number of internet subscribers increased along with the growing social media users on earth. Following table was calculated on June 30, 2012 and shows the increase internet subscription in the world in the last 12 years.

**Table 2:** Increase in the usage of the internet around the world for 12 years. (<http://thesocialskinny.com/216-social-media-and-internet-statistics-september-2012/>)

World Regions	Internet Users Dec. 31, 2000	Internet Users Latest Data	Penetration (% Population)	Growth 2000-2012	Users % of Table
Africa	4,514,400	167,335,676	15.6 %	3,606.7 %	7.0 %
Asia	114,304,000	1,076,681,059	27.5 %	841.9 %	44.8 %
Europe	105,096,093	518,512,109	63.2 %	393.4 %	21.5 %
Middle East	3,284,800	90,000,455	40.2 %	2,639.9 %	3.7 %
North America	108,096,800	273,785,413	78.6 %	153.3 %	11.4 %
Latin America / Caribbean	18,068,919	254,915,745	42.9 %	1,310.8 %	10.6 %
Oceania / Australia	7,620,480	24,287,919	67.6 %	218.7 %	1.0 %
<b>WORLD TOTAL</b>	<b>360,985,492</b>	<b>2,405,518,376</b>	<b>34.3 %</b>	<b>566.4 %</b>	<b>100.0 %</b>

Europe is ranked third row on the rank of internet users as well as the ration of internet usage to population. In order to show ratio of internet subscribers in Europe to usage of social media, the assessment on Facebook is shown in the following table.

**Table 3:** Facebook usage rates in Europe and the world. (Kara, T., 2012)

	Internet Users, 30-June-12	Penetration (% Population)	Internet % World	Facebook 31-Dec-12	İnternet kullanıcılarının Facebook kullanım oranları (%)
<u>Europe</u>	518,512,109	63.2 %	21.6 %	250,934,000	48,40
<u>Rest of World</u>	1,887,006,267	30.5 %	78.4 %	725,009,960	38,42
<b>TOTAL WORLD</b>	<b>2,405,518,376</b>	<b>34.3 %</b>	<b>100.0 %</b>	<b>975,943,960</b>	<b>40,57</b>

When we look at the Balkan countries table 4 comes into picture.

**Table 4:** Internet subscription and Facebook usage rates of Balkan countries (<http://www.internetworldstats.com/stats.htm>)

	Population (2012 Est.)	Internet Users, 30-June-12	Penetration (% Population)	Users % in Europe	Facebook 31-Dec-12	İnternet kullanıcılarının Facebook kullanım oranları (%)
<u>Albania</u>	3,002,859	1,471,400	49.0 %	0.3 %	1,097,800	74,61%
<u>Bosnia-Herzegovina</u>	3,879,296	2,327,578	60.0 %	0.4 %	1,345,020	57,79%
<u>Bulgaria</u>	7,037,935	3,589,347	51.0 %	0.7 %	2,522,120	70,27%
<u>Croatia</u>	4,480,043	3,167,838	70.7 %	0.6 %	1,595,760	50,37%
<u>Greece</u>	10,767,827	5,706,948	53.0 %	1.1 %	3,845,820	67,39%
<u>Kosovo</u>	1,836,529	377	20.5 %	0.1 %	n/a	n/a
<u>Macedonia</u>	2,082,370	1,180,704	56.7 %	0.2 %	962,78	8,15%

(cont.)

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<u>Montenegro</u>	657,394	<b>328,375</b>	50.0 %	0.1 %	306,26	9,33%
<u>Moldova</u>	3,656,843	<b>1,639,463</b>	44.8 %	0.3 %	285,64	1,74%
<u>Romania</u>	21,848,504	<b>9,642,383</b>	44.1 %	1.9 %	5,374,980	55,74%
<u>Serbia</u>	7,276,604	<b>4,107,000</b>	56.4 %	0.8 %	3,377,340	82,23%
<u>Slovenia</u>	1,996,617	<b>1,440,066</b>	72.1 %	0.3 %	730,16	5,07%
<u>Turkey</u>	79,749,461	<b>36,455,000</b>	45.7 %	7.0 %	32,131,260	88,14%
<b>TOTAL EUROPE</b>	<b>820,918,446</b>	<b>518,512,109</b>	<b>63.2 %</b>	<b>100.0 %</b>	<b>250,934,000</b>	<b>48,40%</b>

There are disadvantages as well as advantages of social media platform that affects millions of people and so covers wide range. As long as these disadvantages are not resolved, a threat occurs to the parties involved in platform. For this reason, cost will increase a lot.

### 3.1 Threats Brought By Web 2.0 Technologies

Variety of national and international numerical observations and statistical research in data security problems and financial losses as a result are made frequently. According to result of study made in 2008 by CSI and FBI institutions; 49% of 522 institutions (public or private) in the United States infected with viruses, trojans, worms, etc. experienced malicious code attacks, in 42% of them, mobile devices such as notebook computers, mobile computers were stolen, in %44 of them, employees of the company has abused their access, internet and other authorities and total financial loss of the 522 institution have been 156 million USD (<http://www.internetworldstats.com/stats4.htm>). The result of the research that is made by Clear Swift in 2007 to define the width of social media usage shows how high both individual and institutional damage that internet attacks and abuses cause could be as mentioned above.

The following conclusions were reached in mentioned research (<http://www.internetworldstats.com/stats4.htm#europe>):

- 83% of American employees use office tools to access social media.
- 30% of office workers in the United States and 42% of office workers in the United Kingdom admitted that they talk work-related issues in the social media applications

According to another worldwide research, internet environment and websites are used as the main source in order to spread of new threats and achievement of the purpose in 2008 (Richardson, R., 2008).

Websites, news media sites, social networking sites and advertisers are all sharing personal data about individuals with the goal of more effectively targeting information for those individuals. For example, a news media website might highlight several articles under the heading “Recommended for You” based on age, ethnicity, location, profession and items searched previously. If a user only received news under this heading, it could be limiting. The same principle holds for search engines that filter results according to algorithms that factor a user’s personal information (Akıncı, Z. and Bat, M., 2010).

According to Sophos, people behave quite insensitive against identity theft via Facebook. In late 2009, Sophos conducted an experiment to see how easy it can be to steal vital personal data from Facebook users. By creating two fake Facebook accounts and randomly friending users, Sophos found that 46% of users accepted our friend requests, giving Sophos access to a wealth of information. Of the friended users in their 20s, 89% divulged their full birthdate on their profile. Almost all users posted their email address, and about half listed their town of residence. In the hands of an identity thief, this valuable information can be easily exploited (Global Internet Security Threat Report, 2008)

The rise in the number and popularity of Web sites that allow user-generated content will lead to a significant rise in Web spam and malicious posting of content into blogs, user-forums, and social networks sites for search engine poisoning, spreading malicious lures, and duping users into fraud. Additionally, this threat will be augmented by several new Web attack toolkits that have emerged that allow attackers to discover sites that allow posts and/or have vulnerabilities. Additionally more BOT’s will add HTTP post functionality into their capabilities (Emerging Cyber Threats Report, 2012)

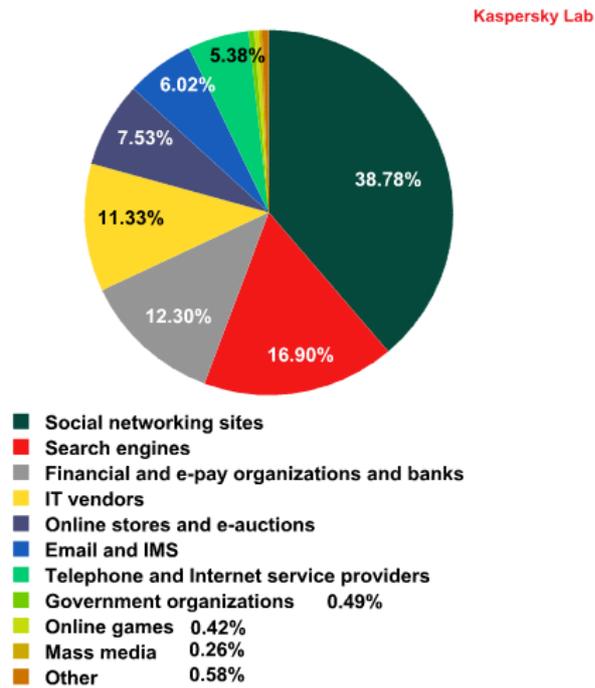


Figure 1: Punishing rates (<http://www.sophos.com/en-us/security-news-trends/security-trends/facebook.aspx>)

In February 2013, the Top 3 organizations targeted by phishers. Social networking sites continued to bear the brunt of phishing attacks, with their share growing inconsiderably (+0.8 percentage points) and averaging 38.8%. Search engines (16.9%) and Financial and e-pay organizations (12.3%) came 2nd and 3rd respectively (<http://www.sophos.com/en-us/security-news-trends/security-trends/facebook.aspx>).

Social networking sites which are a great source for cyber criminals provide an environment for not only credentials that can be stolen but also malicious programs. Figure 2 shows popular social networks are taken aim by malicious programs.

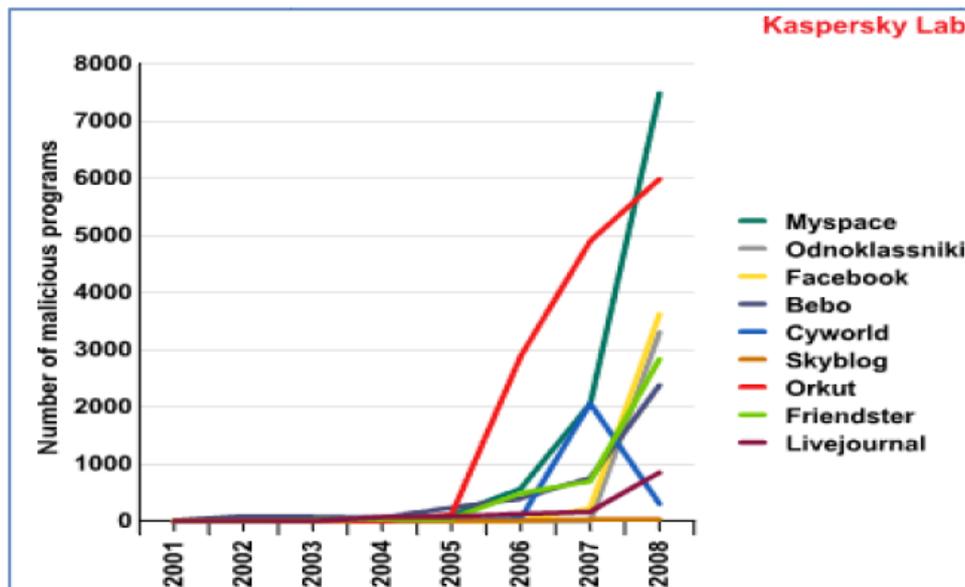


Figure 2: Malicious programs target popular social networks (<http://securitylabs.websense.com/content/Blogs/3255.aspx>)

When we examine figure 2 carefully social networking sites were safer platform until the middle of 2004, after this date it appears that a significant increase in security problems. In particular, social networks as Orkut, Myspace, Facebook, Friendster are threaten. These threats can come directly from social networking sites, and also can be done by using names of social networking sites. The information that is given in the “Social Networking and Security Risk” report published by GFI White Paper in 2011 is an example of this situation.

“Facebook offers thousands of applications that its users can install and run. These applications include calendars that allow Friends to be reminded when it’s user’s birthday, tools to send Friends online greeting cards, quizzes on myriad topics and much more. Many of the applications were designed by Facebook end-users. Although the applications on Facebook may look harmless, and in fact most probably are, there are always some that may deliver malicious content to user’s computer. This holds true not only to Facebook, but also to other social networking sites and to the Internet in general, when downloading from the web or opening attachments in email messages.

Whether you use Facebook, Twitter, LinkedIn or any online site for social networking, online banking or day-to-day purchases, be aware of emails that claim to be from these sites but are actually hoaxes and may contain malicious content. Reaching numerous emails that allege to be from bank, yet are actually sent by a spammer in the hopes of obtaining online username and password. Similarly, emails claiming to be Twitter and Facebook invitations are now commonplace (Figure 2). The messages may even contain an attached ZIP file that recipients are asked to open to see who invited them. The attachment actually contains a mass-mailing worm, which can cause damage to both your computer and your reputation.

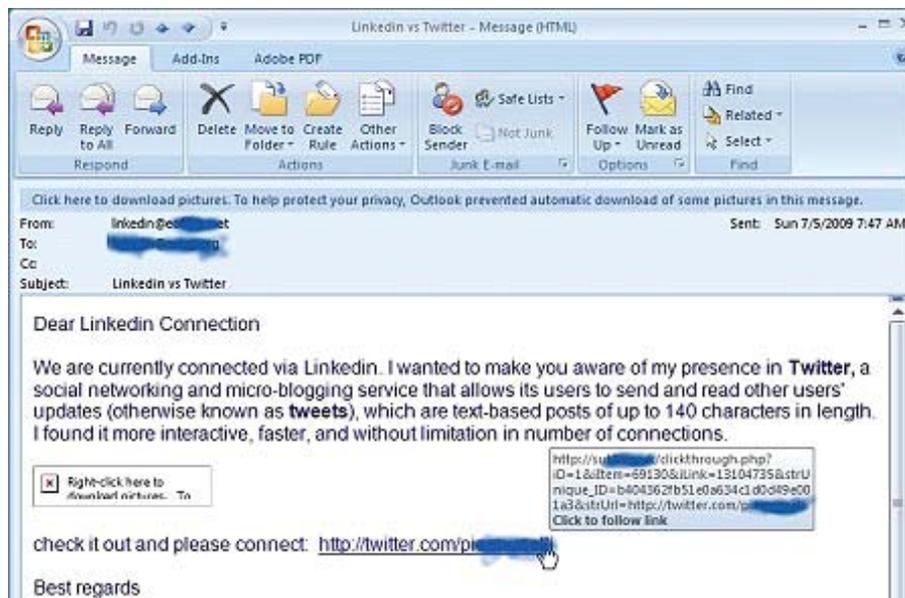


Figure 3: View of malicious mail [36]

The message claims to be from a LinkedIn connection, inviting the recipient to also connect on Twitter. Yet, the sender and the recipient do not actually know each other, and their respective addresses and names were likely gleaned from a spam database. Hovering the cursor over the link near the bottom of the message reveals the URL to the actual spam site; it also contains information that identifies the individual who received this message ([http://www.securelist.com/en/analysis/204792284/Spam\\_in\\_February\\_2013](http://www.securelist.com/en/analysis/204792284/Spam_in_February_2013)).”

With a ratio of 65% in social networking tools, the world's most widely used social networking site is Twitter, it is under attack by persons who is doing unethical search engine optimization, these people also identified as Black Hat SEO. The attack on titles began on February 22, 2010 and still continues today.

Statistics derived from the results of “Panda Security Company”’s research reveals the size of the problem (Gharibi, W. and Shaabi, M., 2012).

- 1,888 Twitter accounts (and growing) have been used to spread the attack URL
- 835 of the 1,888 accounts used in the attack were non-malicious or robots retransmitting the malicious URL automatically
- 2,560 malicious tweets were sent out
- 3,409 target phrases were used in attack
- 9,588 websites linked back to the malicious sites involved in the attack
- The malicious links were clicked on 25,854 times.
- 78% of victims came from the United States, 12% from Korea, and 8% from Germany

When the topic analyzed from different point, malicious people are threatening social media users not only using social media itself but also imitating the interfaces of social platforms via Botnet.

Botnets or anti-social networks, one of the more serious security threats today, can be considered as an antithesis of social networks (Dinerman, B., 2011) Indicated that malware authors can remotely modify web browsers of users of social networking sites such as Facebook and MySpace. Further, malware authors can also manipulate them to launch a DoS attack on other users. It has been estimated that botnets cause huge economic losses and infect millions of computers every year. They have been used as a platform for performing a host of illegal activities such as spreading email spam, performing click fraud, launching Distributed-Denial-of-Service (DDoS) attacks and performing credit card fraud (<http://pandalabs.pandasecurity.com/deep-dive-analysis-on-a-twitter-attack/>).

Another threatening tool is weblogs or spams which target blogs. Weblogs, or blogs are an important new way to publish information, engage in discussions, and form communities on the Internet. Blogs are a global phenomenon, and with numbers well over 100 million they form the core of the emerging paradigm of Social Media. While the utility of blogs is unquestionable, a serious problem now afflicts them, that of spam. Spam blogs, or splogs are blogs with auto-generated or plagiarized content with the sole purpose of hosting profitable contextual ads and/or inflating importance of linked-to sites. Though estimates vary, splogs account for more than 50% of blog content, and present a serious threat to their continued utility (Athanasopoulos, E. et al., 2008).

Splogs impact search engines that index the entire Web or just the blogosphere by increasing computational overhead and reducing user satisfaction. Hence, search engines try to minimize the influence of spam, both prior to indexing and after indexing, by eliminating splogs, comment spam, social media spam, or generic web spam (Athanasopoulos, E. et al., 2008). 428 legitimate sites hosting 4,814 spam pages were founded in Google search results in 2011. That's an average of 11 spam links per domain within the top ranks for popular searches (Patankar, P., 2009). The number of spam pages which are flagged by Google represent only about 44% of all spam identified by Zscaler. If we look at spam pages redirecting to a malware, 57% are flagged. These numbers are about the same as what we saw in March 2010 (53% flagged) (Patankar, P., 2009).

Since social networks have enormous numbers of users and store enormous amount of data, they are natural targets spammers, phishing and malicious attacks. Moreover, online social attacks include identity theft, defamation, stalking, injures to personal dignity and cyber bullying. Hackers create false profiles and mimic personalities or brands, or to slander a known individual within a network of friends (<http://securitylabs.websense.com/content/Blogs/3255.aspx>)

## 4. CONCLUSION

Knowledge is a weapon that is used to achieve the objectives of individual and institutional. today intensive interaction, strong competition make it necessary to share information and as a result it is necessary to have higher capabilities than analyzing, doing business, solving problem. Mentioned accumulation and intellectual infrastructure are defined as head information. Especially after 1995 to obtain information has become easier with the beginning of the wide-spread use of internet which means a network that surrounds the world. such a virtual platform has revealed new business models, individuals and organizations who use internet environment and technology effectively came into prominence in the fields of activity compared to its competitors. Internet platform wherein mentioned has a huge social networking feature. Social media which is a software developed on social networks is a very effective business model. Users can take advantage of gigantic social media and also that should be considered social media has disadvantages that may be threat.

Threats mentioned in the study brings different results in different countries and laws are different from each other seek to control discipline. From this point to reveal the universal law of internet and to provide such a legal confidence to people are seen as important. Another critical point is that it firms and social media platforms allocate higher budgets in order to have sustainable success. Social media users' ability and awareness to use technology needs to be developed through training and information. As a result if users do not share individual and enterprise top secret informations on social networks, that will provide to minimize threats.

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# **CURRENT CONDITION AND PERSPECTIVES FOR THE DEVELOPMENT OF AGRICULTURE IN THE SOUTH CENTRAL REGION OF BULGARIA**

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## **ABSTRACT**

The republic of Bulgaria is a country in which there is a good environment for development. There is a wide variety of potential opportunities for cultivating agricultural crops. The South Central Region is located in the south portion of the country. Its territory comprises the areas of Pazardzhik, Plovdiv, Smolyan, Haskovo and Kardzhali. Agriculture in the region is well developed. Twenty per cent of Bulgaria's utilized agricultural areas are in this region. The agricultural holdings there make for thirty per cent of all farms in the country. The objective of this elaboration is to trace out the main problems of agriculture in the South Central region of Bulgaria.

## **KEYWORDS**

Gross domestic product, gross added value, utilized agricultural areas, specialization in agriculture, agricultural holdings.

## **JEL CLASSIFICATION CODES**

Q100

## **1. ANALYSIS**

The modern advancements in agriculture, the high growth in the production of agricultural raw materials and foods and overproduction of agricultural products in a number of countries cannot conceal the hunger and malnutrition of millions of people around the world. The economically strongest countries, international organizations, and economic groups such as the EU are joined and are including themselves in the solution to these problems via their actions and policies.

Bulgaria has a good environment for the development of agriculture with a wide variety of potential opportunities for the cultivation of many crops.

The country possesses the necessary factors for agricultural production: land in quantity and possessing qualities which can provide raw materials and foods with the needed quality for the population of the country and even more; human capital in quantitative sufficiency with tradition as well as experience; climate and other natural factors.

The development of Bulgarian economy during the period after the year 2000 is relatively good. According to many scientists, analysts and politicians, in 2000 the country has not yet completed the transition to market economy. The agrarian reform in Bulgaria only ended in 2000 and basically achieved its objectives: it replaced the public land ownership with private one – the private sector in stock-breeding is now more than 98 %; in forage crops – 96 %; over 88 % in the meadows; 97 % in the fields and plantations; 98 % in cereals, technical and vegetable crops; it restored in real terms 94,7 % of the land to its rightful owners; it completely restored the property of the labour-agricultural cooperative holdings.

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The state of agriculture in the country and in the South Central region (SCR) in particular we can judge by the macro-economic indicators like gross domestic product (GDP) and gross value added (GVA) – total and per capita.

The GDP created in the SCR from 2000 to 2010 waxed with 134,2 % - a growth that is lower than the one for the whole country, however, the pace of growth is steady and there is neither volatility, nor a decline in it even during 2009 when the severe world economic crisis began. There are economic problems in the SCR and they affect the share that the region holds in the creation of GDP. In 2000 this share is 15,5 %, whereas in 2010 it declines to 14 %. The highest growth of GDP is stated in the Southwest region – 258 %, followed by the SCR with a growth of 134,2 %, while the smallest is the growth in the Northwest region – 55,8 %.

Table 1. Gross domestic product (GDP) and gross value added (GVA) in Bulgaria and in the SCR

Years		Units of measure	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>GDP</b>	<b>Bulgaria</b>	Mln BGN	27 399	30 299	33 189	35 812	39 824	45 484	51 783	60 158	69 295	68 322	70 511
	<b>SCR</b>	Mln BGN	4 237	4 714	4 992	5 547	6 224	7 039	7 843	8 741	8 741	9 776	9 924
<b>GDP per capita</b>	<b>Bulgaria</b>	BGN	3 353	3 829	4 218	4 577	5 118	5 877	6 726	7 857	9 090	9 007	9 359
	<b>SCR</b>	BGN	2 543	2 937	3 130	3 499	3 950	4 495	5 036	5 640	6 340	6 256	6 525
<b>GVA</b>	<b>Bulgaria</b>	Mln BGN	23 983	26 602	29 459	31 199	33 881	38 494	43 424	50 575	57 733	58 695	60 716
	<b>SCR</b>	Mln BGN	3 741	4 139	4 431	4 820	5 295	5 957	6 577	7 346	8 145	8 240	8 545
<b>GVA</b>	<b>Agriculture and forestry</b>	Mln BGN	<b>3 251</b>	<b>3 472</b>	<b>3 489</b>	<b>3 487</b>	<b>3 635</b>	<b>3 491</b>	<b>3 113</b>	<b>2 824</b>	<b>4 132</b>	<b>2 841</b>	<b>2 976</b>
<b>Bulgaria Economic sectors</b>	<b>Industry</b>	Mln BGN	6 208	7 173	7 936	8 634	9 239	11 158	13 379	16 395	17 987	18 395	17 881
	<b>Services</b>	Mln BGN	14 523	15 957	18 034	18 999	21 007	32 845	26 932	31 355	35 617	37 460	39 860
<b>GVA</b>	<b>Agriculture and forestry</b>	Mln BGN	<b>702</b>	<b>699</b>	<b>722</b>	<b>784</b>	<b>852</b>	<b>797</b>	<b>736</b>	<b>693</b>	<b>1 008</b>	<b>616</b>	<b>669</b>
<b>SCR by Economic sectors</b>	<b>Industry</b>	Mln BGN	861	1 087	1 051	1 250	1 444	1 787	2 367	2 867	2 949	3 157	3 257
	<b>Services</b>	Mln BGN	2 178	2 352	2 658	2 786	3 000	3 374	3 747	3 786	4 187	4 468	4 619

*Source: National Statistical Institute (NSI), statistical yearbooks 2001–2011.*

In GDP per capita the SCR takes second place with a growth of 156,6 % for the ten-year research period, following the Southwest region which has a growth of 263 %, while the smallest is the growth in the Northwest region. The higher levels of GDP per capita are related to the fact that the country's population by regions for the period at hand is progressively decreasing as a result of the economic emigration of a large number of the young people and the people of working age plus the demographic collapse in the country.

Leading in the creation of GVA is the Southwest region with a growth of 252.5 %, followed by the SCR with 128,4 %, and the smallest is the growth in the Northwest region – 53,3 %.

Considering the economic indicators GDP and GVA for the period at hand (2000–2010) Bulgaria's development is relatively good with not high but steady pace of economic growth.

The SCR is a region whose agriculture is highly developed. Considering the magnitude of GVA generated by agriculture, the region is first after the Southwest region. The data for the period shows divergent trends: in 2000 SCR's share in the GVA created by the country's agricultural sector is 22,1 %, after which in 2001 it decreases to 20,1 % and stays almost the same in 2002. Then in 2003 it increases and continues to grow during the next two years and in 2007 it reaches 24,5 %. The next two years there is another fall reaching 21,7 %, whereas in 2010 it increases with 0,8 %.

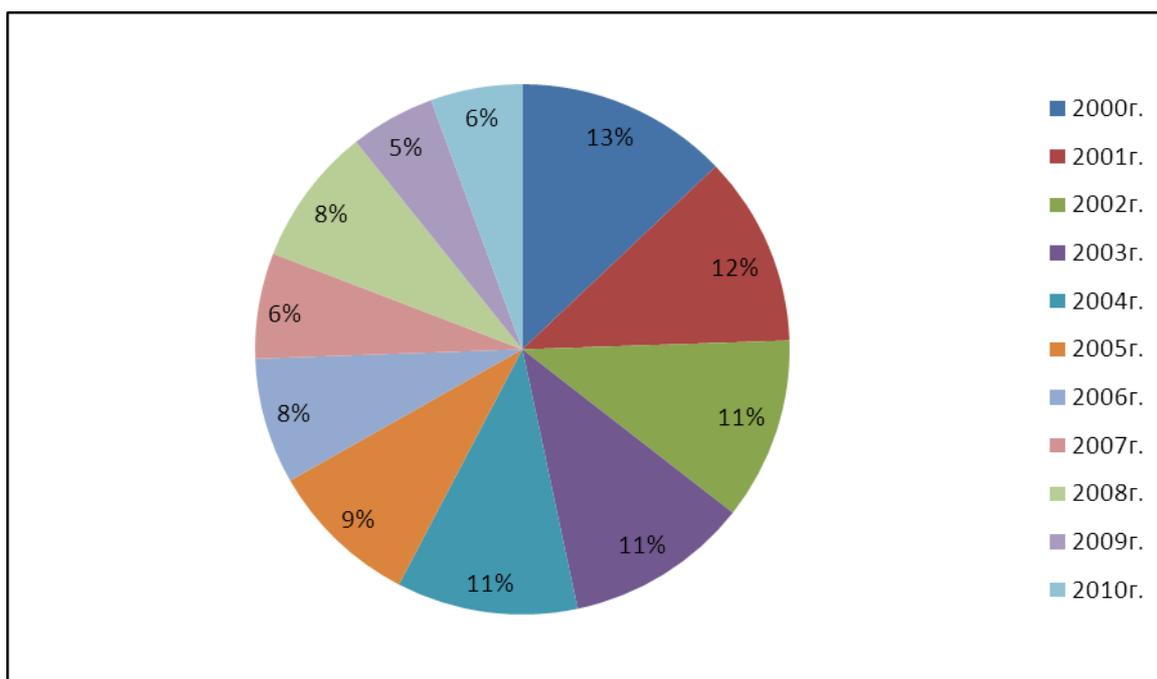


Figure 1. Share of agriculture and forestry in the GVA generated by SCR

Source: NSI, Bulgarian statistical yearbook 2000–2011 and personal calculations

The share of agriculture in GVA generated by the SCR also shows divergent trends, but they are not identical with the abovementioned ones. After 2000 when agriculture's share in GVA generated by the region is 18,8 % a lasting trend of decline emerges. It continues until 2007 and reaches 9,4 %. In 2008 this share increases 2,9 %, followed by a new decline in 2009 and again in 2010 the growth is just 0,6 % and fails to reach the level from 2008.

The analysis of the indicators GDP and GVA for a longer period of time plus the outlined trends in the contribution of agriculture for their creation in the country and by regions show that the sector is sensitive and highly susceptible to changes in economic policy, including policies in respect of agriculture. The chaotic changes of policies are consistent with the erratic changes in the results of the sector's operation, measured by GVA.

Agriculture in Bulgaria has good resource security. The world average rate of arable land per capita is 3dka, here it is 4,6–5 dka. In Europe, Bulgaria belongs to the group of countries with average nutrient reserve of land.

Agrarian production is related to rational use of the most important natural resource – land. A function of the development and the condition of land relations in recent years is the use of land resources.

Bulgarian agriculture over the past 20 years is characterized by inefficient use of land.

According to data from the Ministry of agriculture and foods (MAF) to 2010:

The areas with agricultural purpose (AWAP) is 5 492 891 ha and takes about 50 % of the country's territory. In 2006 the AWAP amounted to 5 709 733 ha, or 51,4 % of the country's territory. In 2010 the AWAP have decreased with 216 84 ha.

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Table 2. *Cropland, UAA and AWAP (ha)*

<b>Work Load</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>
Wheat	1 120 510	1 114 427	1 254 151	1 095 703
Barley	193 840	223 004	264 689	250 640
Rye and triticale	12 030	15 296	17 034	16 116
Oats	25 412	40 230	28 894	24 627
Maize	408 880	348 402	303 881	360 046
Rice	6 454	5 042	6 521	5 277
Other cereals	5 224	8 175	3 288	3 982
Sugar beet	994			
Industrial textile crops	501	199	102	202
Sunflower	686 692	723 962	687 209	734 314
Tobacco	31 144	26 742	27 865	31 652
Industrial oilseed crops	59 389	102 899	115 013	209 347
Other industrial crops	39 954	48 824	60 629	74 536
Potatoes	21 890	21 648	14 068	13 824
Beans, peas, broad beans	5 401	5 868	3 803	3 670
Lentils, chickpea and other pulses	1 291	3 857	5 754	2 169
Fresh vegetables	41 088	30 001	28 715	29 420
Seed beds	3 621	3 314	2 806	3 014
Forage crops, row crops				96
Other forage and annual crops	6 108	7 352	6 349	7 366
Meadows sown with pulses	92 213	99 362	94 226	87 718
Meadows sown with cereals	3 353	2 468	1 183	1 191
Fallow land	291 751	229 471	196 336	207 616
<b>Cropland</b>	<b>3 057 740</b>	<b>3 060 543</b>	<b>3 122 516</b>	<b>3 162 526</b>
Family gardens	25 790	25 763	21 411	21 629
Fruit plantations	75 035	69 893	71 995	72 913
Vineyards – pure crops	103 949	100 873	84 438	82 675
Mixed perennials	9 541	12 759	8 103	8 020
Permanent grassland and meadows in orchards	1 842 141	1 828 865	1 719 028	1 701 990
Greenhouses, sheds and shelters	2 024	2 129	2 094	2 113
<b>UAA</b>	<b>5 116 220</b>	<b>5 100 825</b>	<b>5 029 585</b>	<b>5 051 866</b>
<b>AWAP</b>	<b>5 666 336</b>	<b>5 648 206</b>	<b>5 490 113</b>	<b>5 492 891</b>

Source: MAF, Agricultural statistics

The utilized agricultural area (UAA) is 5 051 886 ha – 45,5 % of the country's territory. In 2000, 5 874 056 ha of land were being utilized in Bulgaria. Many new landowners filled with joy and high expectations got involved in agricultural production. In 2005 data showed a clear trend of reduction of the UAA by 384 447 ha. After 2005 the overall economic environment for the development of business in Bulgaria is good and positive alterations can be expected. In 2009 the world was covered by the financial and economic crisis, which entered Bulgaria with all its consequences. This becomes clear from the data about UAA which in 2009 was 5 029 585 ha. For the period 2007–2010 UAA is constantly decreasing and only in 2010 there is a slight increase in the amount of 22 281 ha compared to 2009.

The cropland in Bulgaria is 3 162 526 ha and represents 62,6 % of the UAA. The trend of reduction for the period 2006–2007 is changing as a result of the promotional role of direct payments and an annual increase is observed during the period 2008–2010. Their size in 2010 increased compared to the previous year by 1,3 %.

Fallow lands in 2010 are 207 616 ha, or 6,6 % of the cropland. The increase of fallow land in 2010 versus 2009 is 5,7 %, whereas in 2000 they are 467 573 ha and continually decrease until 2009 when they are 196 336 ha, which represents 58 %.

The areas with different crops during this period alter contrastingly and it is difficult to delineate a particular trend, more likely is that they are influenced by the situation of the chaotic market in agricultural products in the country. Compared to 2009 in 2010 there is a reduction in areas sown with wheat by 12,6 %, barley – by 5,3 %, rye and triticale – by 5 %, oats – by 14,6 %, rice – by 19 %. Areas sown with potatoes decreased throughout the whole period, the decline is by 36,8 %.

The situation in relation to other traditional Bulgarian productions (grape and fruit) is also negative – the areas under permanent crops (including vineyards) and meadows decrease. Therefore, the use of AWAP is rather unfavourable from the point of view of the production of traditional Bulgarian agricultural products.

The inefficient use of land and abandonment leads to a deterioration in both the quantity and the quality of one of the most important production factors for the industry. The deterioration of the land and its use affected the crop yields, the volume and the quality of production.

During the period after the year 2000 in terms of the formed foundations of private property a process of structuring and restructuring of the agricultural holdings is carried out. At the heart of the organisational economic restructuring of agriculture is the change in the form of ownership. There was no normal economic environment for the agricultural sector, in which perspective forms of organisation to be established, created in the country. The created organizational-economic structure of agriculture was unstable under the existing economic conditions.

Centre of the agricultural reform is the building of new production forms. Unfortunately, for a long time in our country a question and activity of first importance were the breakdown of the former labour-cooperative agricultural holdings (LCAH) and the restoration of agricultural land in real terms to their owners. There was no talk or discussion at State level or at the level of research institutes about new structures. A chaotic and uncontrollable process of creating agricultural structures by the owners and their vision for stewardship started. They had ownership of the land but there were no ideas for its stewardship and management, for its efficient use, for potential markets for agricultural products, for prices and many other problems connected to agricultural production. The provision of landowners with the right to decide for themselves how to process land without advice or support from competent State bodies impeded and slowed down the structural reform.

The construction of new forms of agricultural holdings required time for a change in the thinking and mindset of the whole society. The former members of the LCAH with their collectivism could not convert to private farmers, who successfully work for themselves and their families, for the village, the region, and the national economy. During the years of reform no one taught the farmer-landowner, that land is wealth only when there is complete dedication of all resources, including the landowner's time, has shown that economic operators in their great majority have not made enough effort to achieve what they want or what the society expects of them.

As a result of the radical land reform, the elimination of the LCAH and the destruction of the created market structures, a significant and utterly unacceptable fragmentation of the agricultural structure was accomplished. It included the production system, the infrastructure, markets etc., in which small and medium-sized holdings predominate. Thus, a dualistic structure was created in Bulgaria – presence of a small number of market-oriented major farms and numerous small manufacturers in small semi-subsistence and natural farms.

The structure of agricultural holdings in Bulgaria includes:

Agricultural holdings of natural persons. A characteristic feature is that the sole owner assumes all risk and responsibility for the activity. These farms are economically unstable and do not participate fully with their production in the national economy, for they are not all market-oriented.

Production specialization in natural persons' agricultural holdings is difficult and unstable. Every market fluctuation in terms of prices and quantities leads to a change in the specialization and an annual change of growing crops. These farms are the basis on which the specialization of agriculture can be built using the accumulated and transmitted in families experience and knowledge, as well as labour motivation. Building them as highly efficient specialized farms requires implementation of coordination and liaison between farms. Not only product, but also regional specialization must be actualized as well as participation in service cooperatives and producers' associations in order to provide easier access to markets and involvement with bigger evenly made quality products.

Agricultural cooperatives. In economic literature there is no single definition of the cooperative. As a form of business the cooperative is most commonly defined as members' voluntary possession and control. It is organized and operated for the benefit of its members, i.e. it is owned by people who use it to derive economic benefits from it. It is built for the implementation of certain goals which have democratic, social and humane focus. The economic activity is carried out on the grounds of mutual assistance and cooperation between members in order to satisfy their interests.

Specialization has much greater possibilities for development in agricultural cooperatives. Cooperatives have more production resources than small and medium-sized agricultural holdings. They are able to provide machinery and equipment, employment of qualified specialists and managers of specialised production. Many agricultural cooperatives cultivate lands leased from owners who are unwilling or unable to carry out agricultural production, which gives them the opportunity to develop wholesale production with efficient specialization.

Commercial and other companies. They are a large group of organizational forms that have application in agribusiness.

Companies' potential for organising specialized agricultural production is great. They have much greater resources than other organisational forms and accumulate significant funds that make them a factor for development and implementation of a high degree of specialization in agriculture.

According to the census from the business year 1999/2000, only 42000 of the country's farms produce products for the market, while the rest 720000 produce for their own consumption. This indicates that at this point in our agriculture dominate small farms of self-sufficient producers.

In 2000 there are 760 700 farms in the country 755 300 of which are unregistered producers. The rest 5400 are corporate bodies and sole traders, including cooperatives. They make for almost one per cent of all farms in the country but cultivate 80 % of the UAA, whose average size reaches 540 ha. About 449000 of all unregistered farms belong to people who cultivate their land within cooperatives but individually harvest and bear responsibility for the results. Such are 60 % of the unregistered farms.

Table 3. *Structure of agricultural holdings by legal status and UAA in Bulgaria*

Legal status	2003				2007				2009			
	Agr. holdings		UAA		Agr. holdings		UAA		Agr. holdings		UAA	
	number	%	dka	%	number	%	dka	%	number	%	dka	%
<b>Natural Persons</b>	648 274	99,00	8 796 778,2	30,29	476 956	98,97	10 334 682	33,88	350 900	98,04	1 222 900	33,77
<b>Sole Traders</b>	2870	0,44	3 408 613,8	11,74	1828	0,38	4 087 862,1	13,40	2200	0,61	538 300	14,87
<b>Cooperatives</b>	1973	0,30	1 169 309,5	40,26	1156	0,24	7 263 054,5	23,81	900	0,25	640 700	17,69
<b>Companies</b>	1331	0,20	4 691 970,9	16,15	1763	0,37	7 818 844,7	25,63	3600	1,01	1 145 600	31,64
<b>Association and others</b>	360	0,05	454 338,9	1,56	217	0,05	1 003 006,6	3,29	300	0,08	73 400	2,03
<b>Total</b>	654 808	100,00	29 044 797	100,00	481 920	100,00	30 507 450	100,00	357 900	100,00	3 620 900	100,00

*Source: MAF, Agricultural statistics – personal calculations*

During the same year 2468 agricultural cooperatives that cultivate about 16 mln dka of land function in the country. A cooperative cultivates 6636 dka of land on average. In arable land cooperatives are leaders among the other organisational forms in agriculture.

In 2000 the group of corporate companies included 327 corporate bodies, 8 foreign corporate bodies, 6 associations, 3 religious organisations. In our agriculture there are no production units of non-governmental organisations. During the period 2003–2009 the structure of agricultural holdings is relatively stable.

Natural persons' farms make for 99% of all farms. Their relative share is fairly constant: in 2003 – 99 %; in 2007 – 98,97 %; in 2009 – 98,04 %. Another characteristic feature is that these farms cultivate only 33,77

% of all UAA for 2009. This indicator in 2003 is lower by 3,48 % and in 2007 it increases to 33,88 %, both insignificant fluctuations. Natural persons' holdings maintain their position among agricultural holdings by both indicators. This situation is unfavourable and unacceptable from the point of view of the intensive, specialized, highly effective agriculture.

During the period at hand a decline in the number of cooperatives from 1973 in 2003 to 900 in 2009 is observed. Simultaneously decreases the relative share of the cultivated UAA, i.e. whereas in 2003 40,26 % of the UAA were being cultivated, in 2009 it was 17,69 %. In 2003 cooperatives are leading among the other organisational forms in agricultura in UAA, whereas in 2009 they acquire fourth position with 640 700 dka. Many of their members leave the cooperatives as private farmers, give their land on lease or sell it to larger-scale farmers with big specialized farms.

The trend of development in commercial companies is favourable. In 2003 their number is 1331, or 0,2 % of all farms, whereas in 2010 they are 3600, or 1,01 % of all farms. A significant growth in the relative share of the UAA they cultivate from 16,15 % in 2003 to 31,64 % in 2009 is being observed. The relative share of the associations in Bulgarian agriculture for the period 2003–2009 remains relatively constant about 0,05 % of all farms, which is an opportunity for development of specialization of agricultural production.

Table 4. Relative share of agricultural holdings according to their legal status and specialization (in %)

Crops	Total			Natural persons			Sole traders			Cooperatives			Commercial companies			Associations and others		
	2003	2007	2009	2003	2007	2009	2003	2007	2009	2003	2007	2009	2003	2007	2009	2003	2007	2009
<b>Total</b>	100	100	100	99,0	98,9	98,9	0,4	0,4	0,4	0,3	0,3	0,2	0,2	0,3	0,4	0,05	0,05	0,05
<b>Cereals</b>	100	100	100	98,7	71,6	96,8	0,5	0,7	0,9	0,5	0,9	0,9	0,2	0,2	0,9	0,05	0,07	0,09
<b>Leguminous</b>	100	100	100	99,6	99,5	99,6	0,2	0,2	0,2	0,1	0,1	0,1	0,06	0,1	0,09	0,3	0,03	0,06
<b>Oil crops</b>	100	100	100	91,6	82,4	88,4	2,4	21,1	3,7	4,02	30,5	4,7	1,7	16,06	4,2	0,3	2,2	0,3
<b>Fibre crops</b>	100	100	100	50,0	62,9	78,9	-	-	3,5	34,5	25,7	10,5	10,3	8,6	5,2	0,6	2,6	0,8
<b>Essential-oil and medicinal crops</b>	100	100	100	82,7	83,5	83,5	3,6	2,9	3,4	8,5	7,2	4,6	4,7	6,0	8,6	0,6	0,3	1,7
<b>Forage crops</b>	100	100	100	99,2	98,9	98,5	0,3	0,5	0,6	0,3	0,4	0,4	0,1	0,2	0,4	0,05	0,07	0,08
<b>Fresh vegetables</b>	100	100	100	99,6	99,5	99,6	0,3	0,2	0,3	0,05	0,04	0,05	0,06	0,09	0,1	0,02	0,03	0,02
<b>Fruit plantations</b>	100	100	100	98,3	89,3	98,4	0,6	0,6	0,4	0,5	0,3	0,3	0,3	0,4	0,6	0,2	0,2	0,2

*Source: MAF, Agricultural statistics. Newsletters on the structure of agricultural holdings 2003–2011 and personal calculations*

Natural persons' farms differentiate in their goals and way of functioning. They exist with the main goal of satisfying their own needs and simple reproduction. Some of them participate on the market with their production only when its quantity exceeds their own needs and are known as semi-subsistence. Holdings of corporate bodies realize their production entirely on the market.

The cultivation of agricultural crops in the different types of agricultural production on holdings with corporate status happens exclusively in natural persons' holdings.

Leading among the cereals are the holdings of natural persons with relative share over 95 %, which only in 2005 is lower – 71,6 %, without this being accompanied by a high increase in the relative shares of other types of holdings. These holdings have significant quantities of UAA which gives them the opportunity for narrow specialization. They are followed by the cooperatives, sole traders and commercial companies but their relative share is significantly smaller – 0,9 %. The participation of associations and other businesses in the cultivation of cereals has an insignificant relative share.

With leguminous crops the situation is the same. Here the share of natural persons' holdings is almost 100 %, while all the rest have shares under 1 %.

In oil crops the highest share again belongs to holdings of natural persons. It varies from 91,65 % in 2003 to 82,1 % in 2007 and 88,4 % in 2009. All other forms of holdings except for the group of associations and others have over 1 %. In 2005 the share of sole traders is 21,1 %, of cooperatives – 30,5 %, and of

commercial companies – 16,06 %, which indicates that the specialization in the production of oil crops also covers these business forms.

Of all fibre crops cotton is cultivated mainly in the holdings of natural persons between 50 and 79 % for the period 2003–2007. Also significant is the share of cooperatives. However, in recent years it has decreased just like with commercial companies.

Holdings of natural persons are also leaders in the cultivation of essential-oil and medicinal crops, followed by the cooperatives but there is a clear trend of decrease, whereas the share of commercial companies increases.

In the cultivation of forage crops, fresh vegetables and fruit plantations again leading are the holdings of natural persons. This is a lasting trend, the participation of the other business forms is very small and so is their share in the total number of holdings in the country.

The cultivation of all groups of agricultural crops at hand is concentrated in holdings of natural persons that are normally small, suggesting a lower degree of intense development and efficiency of agricultural production.

Considering the analysis and the evaluation of the combined research of the holdings in legal status, UAA, and the specialization in types of cultivated agricultural crops we can conclude that a large portion of the holdings have adopted and implemented a strategy of survival without development. They do not seek to maximize profits, but rather to minimize risks by exercising various types of activities – diverse product specialization, in which the winning production compensates the losing one in order to ensure the survival and reproduction. The preferred option is the holdings to be financed with their own resources. Therefore, in Bulgaria the social stimuli for engaging in agricultural activity are much stronger in comparison with economic ones.

Unlike European agricultural structures, whose transformation has lasted many years and their adaption to the challenges of external environment was carried out smoothly, in Bulgaria remains the task of restructuring in significantly shorter time limits. Particular in the case of the new European members is that they cannot follow literally the steps and stages that European agriculture has undergone due to the difference in the factors of the external environment, the force and direction of action, as well as the specific national characteristics.

In Bulgaria the structure problems in agriculture and specifically the lack of enough large specialized holdings (except producers of cereals) create significant obstacles for the full realization of its potentially high competitiveness. The strong fragmentation of agriculture leads to specialization with low efficiency, increased production costs and delivery of quality agricultural raw materials and low profit.

The analysis and evaluation of the condition and problems of agriculture in the SCR's holdings is formed on the basis of information derived from a survey of agricultural holdings, carried out during the period 2009–2011.

The choice of sites is dictated by their great diversity and distribution around the SCR and its largest district – Plovdiv. The district of Plovdiv and the selected municipalities have some of the best soil and climatic factors for the development of specialized agricultural production. Plant production is highly developed – grain production, vegetable growing, fruit-growing, viticulture, essential-oil crops, tobacco – over 100 kinds of agricultural crops are cultivated.

The number of surveyed holdings is 65, 21 in the municipality of Rakovski, 16 in Sadovo, 14 in Rodopi municipality, 14 in Brezovo. Holdings with different production specialization and organisational status are sought out in order to discover the links between the main characteristics and features of agricultural holdings and their problems, opportunities and guidelines for development of different types of specialization.

Highest share of all surveyed holdings have the ones of natural persons – 75,38 %, followed by associations – 12,31 %, sole traders – 7,69 %, and cooperatives – 4,62 %.

Each holding has infield of different size. The biggest differences are in the farmers' holdings – over 4761 times, and the smallest are in cooperatives – over 10 times.

The different specialization is the reason for differences in farmers' holdings. The ones specialized in mushroom-growing have minimum arable land, whereas in holdings specialized in grain-production the maximum recorded size is almost 65 000 dka.

In cooperatives differences are small due to their approximately similar specialization.

Most numerous are the grain-production farms – 22, followed by vegetable growers – 16, then come the farms specialized in viticulture – 11, fruit-growing – 9 farms, and mushroom-growing farms are the least.

This production specialization is determined by many factors: traditions, experience and skills accumulated through the ages; development of knowledge and of the proceedings on the basis of scientific excellence in the field of agriculture developed in many universities and research institutes, and experimental stations located in the SCR esp. in Plovdiv municipality; modern development of the agricultural market – national, European and worldwide.

The farms in any one of the specialization types have different organisational forms. In the most numerous farms specialized in grain-production all organisational forms are detected. Data indicates that 100% of the surveyed companies and agricultural holdings have cereal-specialization.

Vegetable growing farms compose 24,61% of all surveyed holdings and all farmers' holdings. All fruit and mushroom-growing holding are also farmers', except for one holding (in each).

Holdings in various organisational forms are characterized with varying degrees of activity diversification. This difference stems from the size of the farm and the organisational form. A large portion of the farms simultaneously cultivate vegetables, cereals, vines, etc. Such are most of the farmers' holdings, which strive through product diversification to diversify their sources of income in order to achieve relatively greater stability in income, a reduction of market and the climatic risks to which they are exposed.

Survey data indicates that farms differ greatly also in the relative share of rented land. Even in holdings with the same specialization and organisational form occur differences in the size of one's own and rented land. In agricultural cooperatives, associations and sole traders a large part of the lease contracts are for a four-year period or more, whereas with farmers lease contracts are short-term – from 1 to 3 years.

Small and medium-sized farms prefer short-term annual rent contracts, since they are highly dependent on market fluctuations and one meltdown can make rent payments impossible. The small financial capabilities of these holdings deprive them of the opportunity for long-term investments to increase the fertility of the land, to introduce wide-span cable equipment, land-reclamations and other such actions that would make profitable long-term contracts. Of interest for large farms is exactly the opposite, they strive for more long-term rent agreements, since they give them the possibility of full return and receipt of additional income in the long term investment in agricultural manufacturing associations.

The safety of tangible fixed assets (TFA) and the use of machine-tractor parks vary in different farms. 30,77 % of the surveyed holdings do not own tractors and the lowest is the number of tractors owned by farmers. In the majority of cases the technique is morally and physically obsolete, leading to additional costs for maintenance and difficulties operating it. Smaller farms have outdated machines, while the medium-size farms have updated or intend to update their machine-tractor parks by purchasing new high-performance agricultural machinery. Most of the holdings, esp. those of farmers, use external services to carry out mechanized operations due to their lack of equipment. The percentage of the holdings whose available inventory is assessed at own discretion as insufficient is high.

Farms specialized in grain-production have the best technical saturation and possess a greater number of tractors and combines to implement their production activities. Minimum equipment have the holdings specialized in mushroom-growing.

Of interest is the link between the specialization of the holding and the direction of income changes. The analysis of this connection allows us to define the productions in which farms could be competitive on domestic, European and other international markets.

The accession of Bulgaria to the EU affected the incomes of agricultural holdings in different ways. The survey results indicate different trends in the income changes of agricultural holdings. One of them is negative – 47,69 % of farm-owners share that after 2007 their income declined significantly. As main reason they point out the high-level competition in the common market of the EU, for which Bulgarian farms are not prepared. The income of 35,38 % of the holdings remains unchanged. Only 16,93 % of the holdings' income increase.

The analysis of the survey data gives us reason to print the following trends: for the most part – 60 % of the grain-production specialized holdings after 2007, income increase, for 68,8% of the vegetable growing specialized holdings the change in income is negative. The same trend has emerged for farms specialized in viticulture and fruit-growing – respectively 82% and 56% have reduced their income, while for the vast majority of mushroom-growing farms – 57%, income hasn't changed materially for the period after 2007. These trends in the development of the link between specialization and income change in holdings require the efforts of farms to be directed toward production specialization that will positively affect their income and may lead to their significant increase.

## 2. CONCLUSION

- The development of agriculture and its specialization are closely related to the amount of arable land agricultural holdings possess.
- Agricultural holdings with similar in size arable land have approximately similar specialization.
- The specialization of production directly affects employment in agricultural holdings. The production of vegetables, fruit, grapes and mushrooms is highly labour-consuming, while the largest share of the surveyed holdings specialized in grain-production 33,8% have minimum employment.
- There is a close link between the organisational form of agricultural holdings and their specialization. Multitask specialization is characteristic of many of the small farmers' holdings with the goal of diversifying income.
- The chosen agricultural specialization of production directly affects the certainty of TFA.
- The influence of different types of specialization on the functioning of agricultural holdings can be traced and proved with the alteration of the economic efficiency of these holdings.

The multilateral calculations and their analysis indicate:

- The surveyed specialized holdings are cost-effective but the trends of development of the specialized holdings and their economic efficiency are divergent.
- Specialization in grain production has increasing economic efficiency, therefore, the size and number of these farms is constantly growing.
- For other types of specialization has emerged a lasting trend of decline in economic efficiency, as the most serious and constant decline is in vegetable growing.
- There is a fundamental link between production specialization and the received direct payments. They stimulate mainly grain-production.
- The membership of farms in producers' organisations depends on their specialization and allows an increase in competitiveness and production efficiency.

The main priority of Bulgarian agricultural policy is to create conditions for more effective use of resources in agricultural production and to enhance the competitiveness of the products on international markets. That can be accomplished by deepening and perfecting the specialization of Bulgarian agricultural production.

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# LIMITS OF GROSS DOMESTIC PRODUCT IN CHARACTERIZING ECONOMIC WELFARE

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## ABSTRACT

This paper aims to present primarily the weaknesses of the most important macroeconomic aggregate, the Gross Domestic Product (GDP), in the characterization of the material welfare of citizens. Although the inadequacy of GDP in measuring economic welfare is widely accepted in theory, it is still used as a key indicator of economic policies. This article intends to provide some evidence for the theoretical criticism made to GDP, with reference to the case of Romania, taking into account three essential components in describing material welfare of the citizens in a country : the social, economic and environmental part. Having as a starting point the assumption that private expenditure of GDP are crucial in quantifying the real consumption possibilities of individuals, an indicator based on private consumption is proposed, which is adjusted with certain values of benefits and costs concerning environmental and social components, considering also the income inequality in the society. The comparative analysis of GDP and this new adjusted indicator of private consumption is reflecting a general trend upward over the time interval 1990-2009, the two indicators evolving in the same direction but having obviously different levels.

## KEYWORDS

GDP, economic welfare, sustainability, private consumption.

## JEL CLASSIFICATION CODES

E01, E21, I31

## 1. INTRODUCTION

This paper proposes a constructive criticism of Gross Domestic Product (GDP) in terms of quantifying the economic welfare, by taking into account its weaknesses when it is often misinterpreted as representing the best measure of economic welfare.

The chosen theme has attracted many comments and discussions from the advised audience like the media, economists, sociologists, politicians, researchers, teachers, etc. ever since the design of this indicator on which the principal architect, Simon Kuznets, said in his first report to the United States Congress that appeared in 1934 that : “The welfare of a nation can, [...], scarcely be inferred from a measurement of national income [...]” (Wikipedia, apud Kuznets, 1934) and in 1962 that “Goals for more growth should specify more growth of what and for what” (Wikipedia, apud Kuznets, 1962).

From this perspective, the attention on GDP has increased over time mainly focusing on the weaknesses of the indicator regarding the measurement of economic welfare because GDP or GDP per capita is often understood, interpreted and/or commented as designed for this purpose. The present paper does not constitute a proposal to abandon the GDP as a macroeconomic aggregate of the System of National Accounts or a waiver to the measurement of economic activity as a whole, but it represents a point of view more often than not expressed about the limits of GDP in adequately quantifying the welfare of a nation from an economic point of view and also the need for an alternative indicator to take into account variables concerning the environment as well as the social component that are missing from the monetary construction of GDP.

## 2. LIMITS OF GDP IN CHARACTERIZING ECONOMIC WELFARE

### 2.1 The concept of welfare

According to a dictionary of etymology (Etymonline.com), the term “welfare” in the old English language meant “the condition of being or doing well” and in the old Norwegian language “welfare” referred to “social concern for the best of children or of those without a job”, the concept being first attested in 1904, and the term “welfare state” being used a little later, starting with 1941. Until recently, in America, the meaning of “welfare” was linked to “social assistance”, in general for the unemployed people (Hallo.ro), therefore most of the specialized articles are referring and commenting on the aspects of welfare primarily from the perspective of social programs provided by governments through public policy decisions.

Welfare can be defined as a subjective measure of the standard of living of a society, but it is more concerned with quality of life, including factors such as the quality of the environment (of air, soil, water), criminality, the degree of drug abuse, the availability of essential social services, as well as the religious and spiritual aspects of life, the list not being an exhaustive one. A modern sense assigned to welfare explains this concept as representing governmental and non-governmental efforts of a society to help its members to work more efficiently as individuals and as participants in organized social structures.

Economic and social progress are two interrelated concepts, this link being possible by combining economic growth with social cohesion, resulting in the end of a more adequate picture of economic welfare.

A current initiative in this direction was the one launched in February 2008 when the French President Nicolas Sarkozy demanded the formation of a commission to review the issues related to the way in which GDP is measured and the means to find other information necessary to design more relevant indicators of social progress. Thus arose in the autumn of the same year the report of the commission known as “Stiglitz-Sen-Fitoussi Report”, named after the three principal members responsible of the committee : Joseph E. Stiglitz, Amartya Sen and Jean-Paul Fitoussi. The report consists of two sections, a short version and a developed one that addresses three important concepts for the Measurement of Economic Performance and Social Progress “Classical limits of GDP”, “Quality of Life” and “Sustainable Development and the Environment” (Stiglitz et al, 2009).

The report considers that in order to define “welfare” it is necessary the use of a multidimensional definition. Based on academic research and on several practical initiatives developed around the world, the committee identified the following key dimensions that should be taken into account simultaneously, at least in principle:

1. material standard of living (income, consumption and wealth);
2. health;
3. education;
4. personal activities including work;
5. political participation and governance;
6. social connections and relationships;
7. environment (present and future conditions);
8. insecurity, of economic, and of physical nature.

All these dimensions contribute to the welfare of the people and yet many of them are omitted from conventional monetary measures. Quality of life depends on people’s objective conditions and capabilities. Measures should be taken to improve issues regarding people’s health, education, personal activities and environmental conditions. In particular, it should be devoted a substantial effort to the elaboration and implementation of robust measures, reliable, concerning social connections, political voice and insecurity that prove to be important factors for life satisfaction.

The relevant information for assessing the quality of life goes beyond people’s personal opinions and perceptions. What really matters are people’s capacities, the extent to which they can choose and the freedom with which they can choose between the life opportunities that they worth. The choice of functions and capabilities relevant to any measure of quality of life is mostly a value judgment than a technical exercise.

But whereas the exact list of characteristics that inevitably affect the quality of life is based on value judgments, there is a consensus that quality of life depends intrinsically on human health and education, of their daily activities (which include the right to a decent job and housing) of their participation in the political process, of social and natural environment in which they are living as well as by the factors that shape their

personal and economic security. To measure all of these features there are necessary both objective and subjective data. The challenge in all these areas is to improve what has already been done in order to identify the gaps in the available information and to invest in the capacity of statistics in those areas, where available indicators are deficient.

## 2.2 Brief history of GDP

GDP was conceived by economist Simon Kuznets within a report issued in 1934 for the United States Congress (Wikipedia). Cobb et al. (1995) describes it this way: "In 1931, a group of experts from government and the private sector were summoned to a Congress hearing to answer the basic questions about the economy. It turned out that they could not perform the task, the most recent data were for 1929 being rather rudimentary. In 1932, the last year of the Hoover Administration, the Senate asked the Department of Commerce to prepare comprehensive estimates of national income. Shortly thereafter, the department appointed a young economist named Simon Kuznets with the task of developing a uniform set of national accounts. This became the prototype for what we now call "GDP" (Goossens, 2007, apud Cobb et al., 1995). The basic concept of which started the construction of GDP was to comprise the entire economic output of individuals, companies and government in a single measure, which should grow during good times and fall in bad times (Dickinson 2011).

The necessity of this indicator designed during the Second World War consisted in strategic and military assessing, but also in evaluating the performance of the economy after the Great Depression (Voineagu et al., 2009). Ever since the construction of this macro-aggregate, Simon Kuznets drew attention to its use for undefined purposes for GDP namely as a measure of economic welfare. Over the years that followed and particularly from 1960 to the present, the adequacy of this indicator in characterizing economic and social welfare of a nation has been intensively discussed by many respected economists of the twentieth century, including several Nobel Prize winners. Among the best known critics mentioned in the specialized literature are included : Simon Kuznets, J. K. Galbraith, P.A. Samuelson, E. J. Mishan, W. D. Nordhaus, J. Tobin, R. Huetting, F. Hirsch, Amartya Sen, T. Scitovsky, H.E. Daly, J.M. Hartwick, J. Tinbergen, K. Arrow, N. Velling, C. Withagen, M. L. Weitzman, K. - G. Lofgren, P. Dasgupta, K.- G. Maler (Jeroen van den Bergh, 2007).

According to the definition of the National Statistics Institute (Insse.ro) of Romania (Romanian Statistical Yearbook 2010), Gross domestic product (GDP) is the main macroeconomic aggregate of national accounting, representing the final result of the production activity of resident producer units. Simply put, GDP at market prices represents the value of all final goods and services produced within the borders of a country in a given period (monthly, quarterly, annually), usually one year. By dividing it to the total population of the country (in Romania it is used the total country population of July of the year of calculation), resulting GDP per capita, which is often misinterpreted as an indicator that measures the economic welfare of an individual. GDP is calculated by three basic methods: production approach (value added method), expenditure approach (the use of the final output method) and income approach.

## 2.3 Limits of GDP in measuring welfare

First of all GDP as a value result of the observed economy of a country fails to comply paradoxically a basic principle of the accounting system according to which it is required that the registration of assets and liabilities to be carried separately. But on the contrary: GDP sums up together the earnings and costs without making the distinction between transactions that increase economic welfare and those that diminish it.

Furthermore, GDP does not take into account that part of the economy that is not observed, where expenditure are not recorded as well as the informal economy as a whole, thus underestimating the real size of GDP. In 2010, Romania's shadow (grey) economy was estimated at a level of 37.1% of GDP, classifying our country on the second place in the European Union (Asaftei, 2011). Tax evasion of the food industry rises at 7-8 billion euro annually, and two other billion are lost due to tax evasion of tobacco, alcohol and petroleum products (Fin.ro, 2010).

GDP is a measure of market activity, therefore anything that does not have a fixed price attached is excluded. Thus GDP does not take into account non-market activities that are based on the production and consumption which take place outside the market economy reflected by recorded transactions. Unpaid

activities produced and consumed within a household such as cleaning, housekeeping, supervision and care of children and of the elderly, food preparing, repairing of durable goods as well as volunteer services or barter services are not counted in the calculation of GDP, even though most of them could be purchased in a theoretical market framework. However, in the current economic crisis it may occur a transfer of certain activities from the market economy to the informal economy, by which GDP could experience a decline in production. The only cost counted and used in the calculation of GDP is the imputed rent to those having their own property.

GDP does not account for income inequality between different individuals (or different categories of households). Because GDP per capita reflects the average income and not the median one, the states that have unequal income distribution may have a relatively high per capita GDP while the majority of their citizens have low levels of income due to the concentration of wealth at the top of the income distribution, having direct consequences on the opportunities related to personal development and automatically to economic welfare.

GDP does not account for any loss of welfare resulting from an event such as a natural disaster (earthquakes, hurricanes, etc.) or a toxic waste spill, even if the task of cleaning the environment or of the effort to reconstruct a bridge contributes both to economic welfare and to GDP. By relying solely on GDP as a normative indicator in such conditions will lead to an underestimation of the welfare change, because it does not take into account the negative events that triggered the economic activity.

Since GDP takes into account the so-called “defense expenditure” several examples cited in the specialized literature including the costs of commuting to work and the costs related to criminality and accidents, that contribute positively in the calculation of GDP, they do not enhance in general the economic welfare of a society. The same shows the situation in the case of health expenditure: GDP rises when there are costly expenses of medical treatment for the seriously ill patients however this is not a benefic situation for the society’s economic possibilities.

Since GDP takes into consideration only flows, but no stocks, consumption of non-renewable natural resources, such as oil, is counted as an extra in the calculation of GDP, while the remaining stock of oil reserves is not rated as a stock. Natural resources must be properly treated as stocks that are depleted gradually when they are extracted and used. This would lead to a clearer picture of these resources: when the resources are discovered they should be added to the “wealth” of the country and their value should be deducted from the calculation of GDP as they are consumed. Sustainability of growth can thus be considered in the calculation of GDP.

Because GDP measures only those items that have a market price, it automatically excludes elements that are not in the economic sphere, such as a low crime rate, family stability or fresh air. At the same time the “negative” costs such as pollution control expenditure or burglar alarms expenses help to complement GDP even though they contribute little or nothing to the general economic welfare. GDP does not also capture the investments in social capital, such as the investments in communities or social institutions.

In general it can be said about GDP that records only the costs (the means) used to produce results but not the effects produced by the means employed. For example, in a situation where people generally work longer hours this is reflected in a higher GDP but does not equate with a better situation of the people because it affects their time for rest and recreation.

## **2.4 Alternative indicators for the measurement of economic welfare**

Over time, as the confidence in GDP as a standard measure for characterizing the economic welfare of a country decreased there were constructed other indicators to measure more properly the sustainable economic and social welfare. This requires that variables regarding the environment and society to also be included in the calculation of indicators or at least one of these components.

The best known approach in this regard is represented by the Sustainable Development Indicators System designed and developed by Eurostat, being officially recognized.

More recently, starting with the first official EU Conference on the Measurement of Economic Performance and Social Progress “Beyond GDP” in 2007, other indicators have been thoroughly analyzed and considered for future research regarding their potential in exceeding the limits of GDP in this problem. We mention here only some of them (their list not being exhaustive) divided into three main categories, after

Wuppertal Institute that has conducted for each one of them SWOT analyses (Goossens, 2007 apud Wuppertal Institute, 2007), as follows:

#### **2.4.1 Indicators for adjusting GDP**

This category includes those approaches in which traditional measures of economic performance such as GDP or national saving rates, were adjusted by including environmental and social factors, monetary assessed.

From this category the best known such indicators are: Measure of Economic Welfare - MEW, Index of Sustainable Economic Welfare - ISEW, Genuine Progress Indicator - GPI, Green GDP and Genuine Savings-GS or Adjusted Net Savings - ANS.

#### **2.4.2 Indicators for replacing GDP**

The category contains indicators that attempt to evaluate welfare more directly than GDP, for example, by evaluating the average satisfaction (such as the Happy Planet Index) or by achieving basic human functions (such as the Human Development Index).

Among the most discussed indicators tracking to replace GDP in the measurement of a nation's welfare are covered: Human Development Index - HDI, Ecological footprint - EF, Happy Planet Index - HPI and Gross National Happiness Indicator - GNHI.

#### **2.4.3 Indicators for complementing GDP**

The last category consists of approaches that have been designed to complement GDP. Here GDP is not meant to be adjusted or replaced by building new indices but is supplemented with information regarding the environmental and/or social component.

The approach that aims to complement GDP with information on the social medium and the environment one mainly proposes the revision of System of National Accounts by adding such indicators. It is well known thereby the System of Economic Environmental Accounts but also the System of Sustainable Development Indicators.

### **2.5 The case of Romania**

To illustrate more properly Romania's position from the perspective of economic welfare characterization, it was chosen as the main indicator "the final individual consumption of households", the main component part of GDP from its calculation through the expenditure approach.

According to the methodological aspects given by the Romanian National Institute of Statistics the actual final individual consumption of households (private consumption) includes : household expenditure on goods and services in order to meet the needs of their members, individual consumption expenditure of public administrations (education, health, social security and social activities, culture , sports, recreational activities, housing waste collection) and individual consumption expenditure of non-profit institutions serving households.

Given that the largest share of GDP, calculated using the expenditure approach is held by the private consumption and that it is to a very great extent definitive for the consumption possibilities of the citizens in a country, it was chosen as the basis for expressing economic welfare in Romania, following to apply some adjustments regarding the income distribution inequality in the society, public and private expenditure concerning education and health, the costs of pollution by carbon dioxide and with particle emissions and the depletion costs of natural resources, being limited by the lack of data in certain years.

Inequality of income distribution in society is expressed here through the Gini coefficient of inequality that expresses the extent to which the distribution of income (or in some cases of consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution . The Gini coefficient measures the area between the Lorenz curve and the line of absolute equality distribution (the first bisector), expressed as a percentage of the total area under the curve (Anghelache et al., 2006). The Gini coefficient takes values between 0 and 1 but it can be expressed as a percentage through the related index where 0 represents perfect equality and 1 (or 100) represents a perfect inequality. Data on the Gini coefficient for the period 1990-2009 were collected from Transmonee online database (Transmonee.org) and refers to the distribution of population by net household income per capita.

Data on public and private expenditure on education was collected from the Eurostat online database, while health expenditure was selected from the online database of World Bank. Data on public and private health expenditure were only available for the period 1998-2009, the ones relating to public expenditure on education were only available for the years 1999-2005, 2007 and 2009 and data on private expenditure on education were available only for the years 1998-2002, 2005, 2007 and 2009.

The values of GDP for the period 1990-2009 were collected from online database of World Bank. The indicator concerning the damage from particle emissions is expressed in monetary terms as the willingness to pay in order to avoid mortality attributable to particle emissions. The data covers the period 1990-2009 and are drawn from the World Bank online database.

The prejudice due to pollution with carbon dioxide is estimated at \$ 20 per ton of carbon (the unit of damage in 1995 U.S. dollars) multiplied by the number of tons of carbon emitted. This being initially expressed as a percentage of Gross National Income, it has been calculated its value in RON (the national monetary unit in Romania), at constant prices, as a percentage of Gross National Income at constant prices. The data covers the period 1990-2009 and it is collected from the World Bank online database.

The estimated value of natural resource depletion represents the amount of money of net forest depletion, energy depletion and mineral depletion. Net forest depletion is unit resource rents times the excess of wood harvest over natural growth. Energy depletion represents the ratio of the value of the stock of energy resources to the remaining reserve lifetime (capped at 25 years). It covers coal, crude oil, and natural gas. Mineral depletion is the ratio of the value of the stock of mineral resources to the remaining reserve lifetime (capped at 25 years). It covers tin, gold, lead, zinc, iron, copper, nickel, silver, bauxite and phosphate. The data covers the period 1990-2009 and it is collected from the World Bank online database.

The total amount of public spending on education (100%) and 50% of public expenditure for health are added to the basic indicator, the private household consumption, considering these as being benefits in quantifying the welfare of a society. From this indicator are deducted however 50% of private expenditure on education and 50% of private health expenditure, half of which are considered to be defensive expenditure. Other deductions refer to the damage caused by carbon dioxide pollution, particle emissions pollution and to the estimated value of natural resource depletion related to forest, energy and minerals, all of these also being considered defensive expenditure, or costs. The shares of the indicators mentioned above that were added or deducted from the base indicator represent a gross estimation and were chosen in relation with the economic and social situation of Romanias educational and health system but also following the methodological structure of the most important alternative indicator for measuring economic welfare based on private consumption, constructed by Daly and Cobb (1989), Index of Sustainable Economic Welfare.

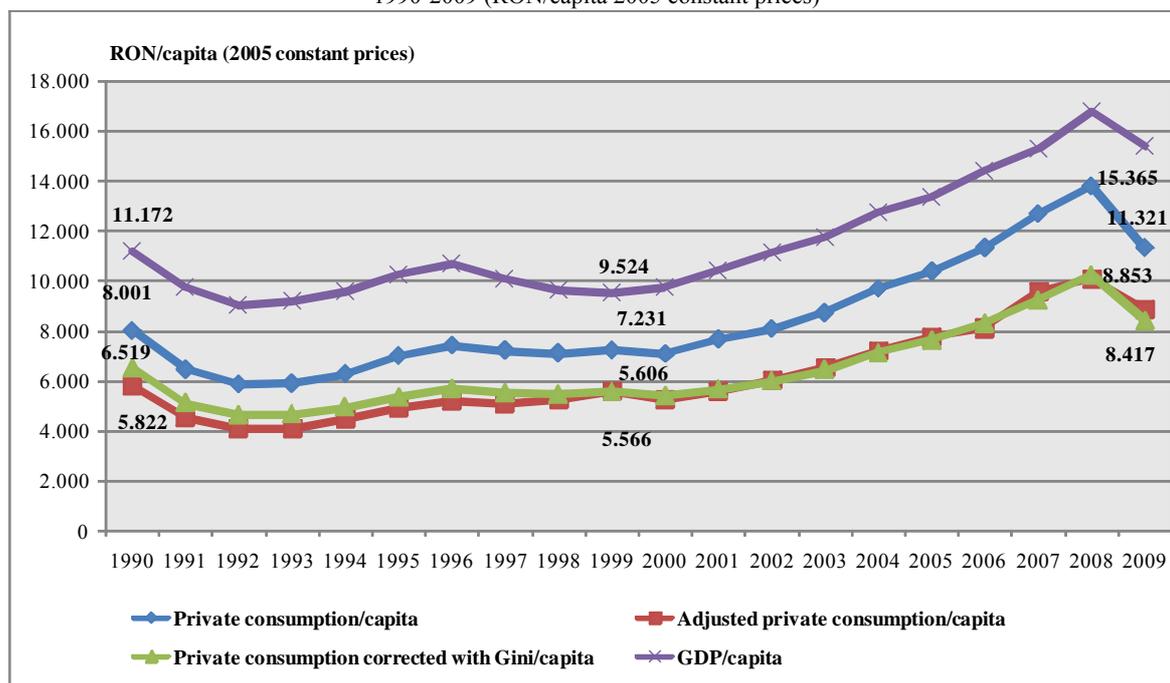
After adjusting the private consumption of household with the values aforementioned, the indicator is finally corrected for inequality of income distribution, by dividing it to  $(1 + \text{Gini inequality coefficient})$ .

The comparative analysis of GDP and the "Adjusted private consumption" is shown below in Figure 1. where the indicators are expressed per capita (indicators were divided by the average total population of 1<sup>st</sup> of July of each year of the analysis), with data presented in Table 1.. The "Adjusted private consumption" refers to the value of private consumption adjusted (+/-) with the monetary components concerning the social and environmental parts mentioned above and finally corrected with the Gini index. The "Private consumption corrected with Gini" refers to the value of private consumption corrected only for inequality of income distribution but not including other adjustments.

The comparative analysis of their evolution shows a general upward trend in "parallel", the level of the adjusted and corrected private consumption maintaining at approximately half of the GDP value during the 1990-2009 time interval on the understanding that in last year of study the value of all of the indicators decreased together due to the effects of economic recession.

In the first 3 years of the analyzed period, 1990-1992, GDP decreases along with adjusted and corrected private consumption and its versions. The next period was one of economic growth reflected by GDP growth between 1993-1996, the same upward route being followed by private consumption, the adjusted and the corrected one for inequality. The year 1997 marks the change of political leadership, a factor that influenced the economic situation, which recorded a decline by reducing GDP until 1999.

Figure 1. Comparative analysis between GDP/capita, private consumption and its transformed versions in the period 1990-2009 (RON/capita 2005 constant prices)



Data source : WorldBank, Eurostat

In the middle of the considered period, namely in 1999, it is noticed an increase of the adjusted private consumption whereas the GDP of that year declines against the previous year. This may be due in part to the availability of all data for adjustment in 1999.

Another interesting thing to notice here is that the adjusted and corrected private consumption relatively stagnated in these two years following that from 2000 up to 2008 to register a continuous growth, along with the upward trend of GDP and private consumption, but moving away from their routes as seen in Figure 1., thereby making the difference between them to widen.

Table 1. GDP/capita, private consumption/capita and its transformed versions in the period 1990-2009 (RON/capita 2005 constant prices)

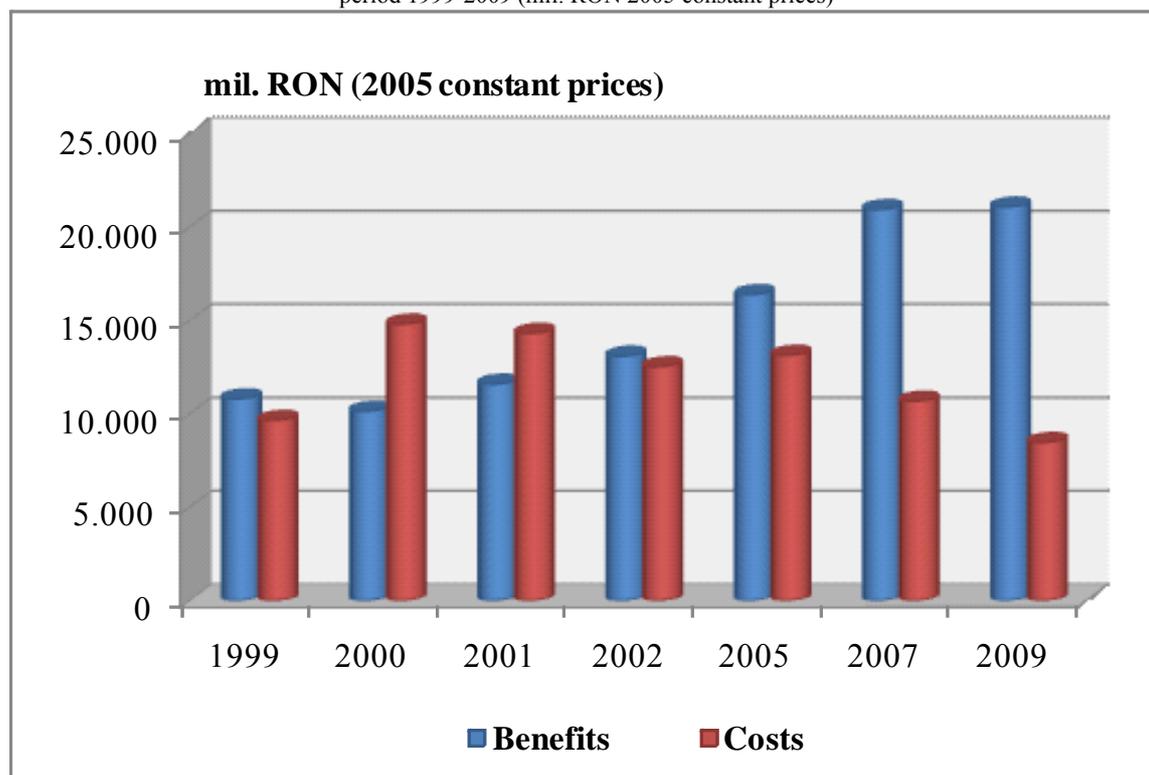
Year	GDP/capita	Private consumption/capita	Adjusted private consumption/capita	Private consumption corrected with Gini/capita
1990	11172.0	8001.4	5822.5	6518.6
1991	9740.0	6441.6	4517.6	5120.2
1992	9033.3	5855.5	4101.8	4650.5
1993	9183.5	5902.8	4112.4	4657.4
1994	9558.2	6258.3	4511.1	4951.3
1995	10265.1	6989.4	4940.3	5353.6
1996	10711.1	7421.4	5203.1	5700.0
1997	10081.5	7202.8	5117.5	5517.5
1998	9620.5	7097.1	5268.8	5467.7
1999	9524.1	7230.6	5605.7	5566.2
2000	9730.6	7072.3	5240.0	5398.7
2001	10429.7	7655.8	5567.7	5658.5

(cont.)

2002	11127.0	8077.9	6007.3	5988.1
2003	11738.5	8717.1	6546.4	6447.6
2004	12758.1	9683.6	7191.5	7125.5
2005	13321.4	10372.8	7731.9	7621.5
2006	14404.9	11318.5	8104.1	8298.0
2007	15298.1	12688.3	9574.1	9227.8
2008	16765.9	13793.1	10063.8	10239.8
2009	15364.5	11320.6	8853.4	8416.8

By comparing the values in Figure 2. that represent the added benefits and the deducted costs (defensive expenditure) to and from the private consumption in the years for which the data were available for all of the indicators, meaning 1999-2002, 2005, 2007 and 2009, it can be seen that until 2002 the benefits and costs had relatively equal levels, fluctuating on this period but starting with 2005 the benefits started to raise and also the difference between the two aggregates, the defensive expenditure representing in 2009 about one third of the expenditure considered benefits, this process being explained by the considerable reduction of private expenditure on education and of the value of natural resource depletion in the last year.

Figure 2. Comparative analysis between the added benefits and deducted costs to and from the private consumption in the period 1999-2009 (mil. RON 2005 constant prices)



### 3. CONCLUSIONS

The assessment according to which GDP is an indicator that insufficiently and inadequately measures economic welfare taking in account the sustainability but also the need of countries to assess both the sustainable economic performance and the social progress led to the development of alternative indicators with respect to the supreme quality of GDP to express economic development into a single number.

Comparative analysis of GDP and of the adjusted private consumption revealed that they move in tandem over the period of analysis 1990-2009, the adjusted private consumption accounting for about 50% of GDP on the analyzed interval, the economic welfare thus quantified being up to half reduced in value terms than the main macroeconomic aggregate is trying to reflect. Sure that still remain numerous adjustments to be estimated concerning GDP limits, the most important of them being the assessment of unpaid household labor.

Waiving of GDP in regarding the use of it in the characterization of economic welfare of a country should not be confused with proposals of “anti-development”, “anti-innovation” and “anti-accounting” as specified by and Jeroen van den Bergh, in the end of the article “Abolishing GDP” (Jeroen van den Bergh, 2007).

For a long time the evolution of the System of National Accounts has allowed policy makers to a vision of an increasingly differentiated market economy, so that they can use better constructed alternative indicators from a social and economic point of view that would help to the inclusion of those questions that place the economy into a broader social context.

The summary criticism of GDP in the present paper is directed towards the way in which it (GDP) adequately expresses the economic welfare of a nation, including also the social and environmental components, and also on how it is interpreted and used in public debate and policy decisions and should not be misinterpreted as a criticism of the System of National Accounts. Today it is necessary to get over the “GDP fetishism” (Stiglitz, 2009) and to no longer question whether or not it properly measures collective economic welfare but to continue improving the methodology of recent indicators built to adjust, complement or replace the most important macroeconomic aggregate of our time with essential information on society and environment.

As Stiglitz stated in a recent book of his (“Freefall : America, Free Markets, and the Sinking of the World Economy”) “no indicator alone can capture the complexity of what is happening in modern society, but GDP indicator has drawbacks of a crucial relevance” (Stiglitz, 2010).

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# THE ROLE OF ADDITIONAL PENSION PLANS IN SELECTED COUNTRIES IN CENTRAL AND EASTERN EUROPE

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## ABSTRACT

In large parts of the world poverty risk among elderly people is a serious problem. In recent years the pension issues have taken on a specific meaning, which is associated with the process of ageing population and financial instability of numerous pension schemes. In the last decade of the 20th century there have been numerous pension reforms in many countries in the world, including the Central and Eastern Europe. They reformed the existing schemes based on the principle of pay-as-you-go pension schemes, introduced mandatory pension funds and enabled to make additional retirement savings in private pension programs. Nowadays CEE countries still make some adjustments of their pensions system in the defined contribution formula due to the fact that these countries are facing even more extreme demographic ageing than those in western Europe. Pension reforms put risk on future pensioners. In accordance with the common tendency, lower replacement rate from common public pension programs will lead to a greater role of additional pensions. The aim of the present article is to depict the role and circumstances of the development of additional pension programs in selected countries in the Central and Eastern Europe.

## KEYWORDS

pension system, additional retirement savings, replacement rate, CEE

## JEL CLASSIFICATION CODES

H24, H55, J11

## 1. INTRODUCTION

In the recent years the issue of pension plans has gained greater significance due to the ageing processes of modern societies and lack of financial stability of particular pension plans. In numerous states worldwide in the last decade of the 20 century there were many reforms of the pension security systems. These changes concerned former pension plans based on the rule pay-as-you-go and aimed at introducing mandatory, capital pension funds as well as facilitating additional pension saving in private pension schemes.

Till 1989 the system of pension security in the countries of Central and Eastern Europe was based on similar rules. Its characteristic functioning was pay-as-you-go, where the state had to secure pension for the old age, retirement age was lower than in Western European countries<sup>1</sup>, there was a range of possibilities to obtain pension earlier and high rates of replacement of salary with pension (Hacker, 2009). In general, pension plans in CEE countries before the reforms could be characterized as two-pillared. The first pillar was mainly pay-as-you-go while the second pillar was capital and included all voluntary forms of saving for the

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<sup>1</sup> While in 1990 the average retirement age in CEE countries was 59 years for women and 61 for men, the mean for OECD countries was 60 years for women and 62 years for men. Additionally, the actual retirement age in CEE countries was even lower as to obtain full pension it was enough to have 20 to 25 years of insurance period. See (Fultz, Ruck, 2001).

old age. As a result of the reforms, in CEE countries the system was changed into a three-pillared, though there are significant differences in the accepted solutions within particular pillars (Chybalski, 2009).

The reforms of pay-as-you-go pension schemes were necessary due to cumulating financial difficulties and related problems with solvency of public pension schemes. Moreover, the conditions in which these pension schemes functioned changed radically. In the countries of transformation where unemployment occurred, there was a pressure to get earlier retirement statement or disability insurance. Consequently, the weakness of former pension schemes inherited after the old system came to light (Żukowski, 2006). The paradigm of introduced changes was greatly varied among countries. These reforms in CEE countries were parametric, i.e. parameters of former schemes were changed, and structural (systematic) which changed the structure and goal of the system, which in CEE countries was to introduce the system of notional defined contribution (NDC) and capital pension funds. Among the countries undergoing political transformation the first country which introduced NDC formula was Latvia, in the next years Poland and Russia.

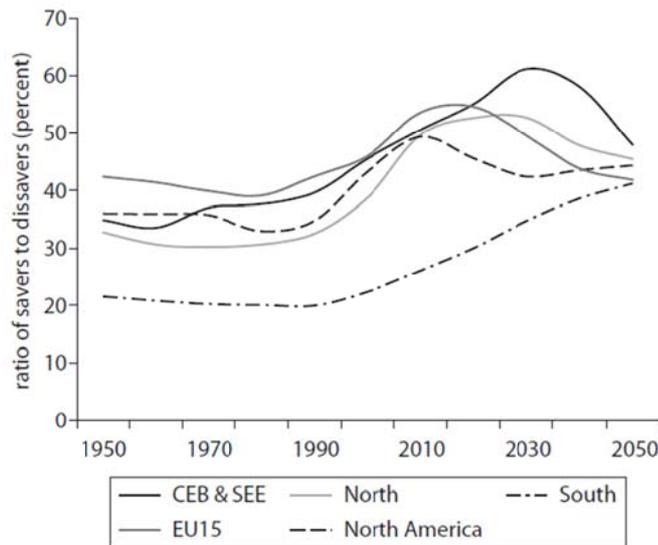
Many countries, such as Bulgaria, Estonia, Hungary, Romania, Slovakia, Slovenia and Czech Republic, opted for the system of defined contribution. Some countries went towards more radical changes based on partial or total privatization of the pension scheme. For instance, in Hungary (1998), Poland (1999), Latvia (2001), Bulgaria (2002), Croatia (2002), Estonia (2002), Lithuania, Slovakia (2005), Romania (2008), the system which was introduced was mixed, i.e. it included public pay-as-you-go basis in the first pillar and, following the Chilean formula, capital pension funds in the second pillar. Only Czech Republic did not introduce capital pension funds. In Slovenia, the second pillar is mandatory only for certain professions whereas Lithuania and Slovakia (since 2008) have agreed on voluntary participation in such schemes.

Due to economic slowdown and the crisis in the sector of public finances as well as growing deficit of pension systems, in the recent years there has been another reaction in the form of changes in certain parameters of pension schemes in CEE countries. In order to improve the balance of pension schemes, the changes assumed either lower expenditures on pensions or higher contributions. To illustrate, Romania in 2008 decided to raise the general contribution rate from 27.5% to 31.3%, Lithuania lowered its contribution rates for capital fund from 5.5% to 2.0% in 2009-2010 (and then increased to 6% in 2012-2014), while in 2008 Slovakia agreed to the voluntary participation in the capital pension scheme of the pension system. Some countries also decided to transfer part of the contribution from pension funds to the basic system and to agree on voluntary participation in this part of the pension scheme (Chłoń-Domińczak, 2010). A special example is Hungary where the second pillar was nationalized by closing down mandatory capital pension funds and that allowed transferring the money to the first pillar. As a result, at the end of 20011 only 1.5% people in working age remained members of these funds. Nonetheless, it needs to be stressed that changes of pension schemes in many CEE countries in fact started with the introduction of the possibility to voluntary save for the old age, which in fact took place before capital mandatory pension funds had been created.

## **2. THE REASONS BEHIND GROWING INTEREST IN VOLUNTARY PENSION SAVING PLANS**

The process of ageing observed in contemporary societies is the consequence of what one may call the *first longevity revolution*, where the medical progress, higher level of education and improved socio-economic situation of society allow more people to live longer than ever before. CEE countries seem to face this problem more seriously than Western European countries. Though the society of CEE region is currently relatively young in comparison to other regions of the world, it is forecasted that in the foreseeable future the number of pensioners in the resources of working population will be significantly bigger, reaching the level of Western Europe not later than in 2030. CEE countries have the lowest total fertility rate (TFR) and according to the forecasts this situation will continue in the next decades. This tendency is confirmed by Holzmann and using a basic demographic rate, which is the ratio of population aged 40-64 (age in which the biggest number of people save) to people under 40 and over 64 (when the smallest number of people save) indicates that CEE countries, Baltic Sea countries and South-Eastern countries are particularly at risk of rapid fall of saving citizens and, consequently, a real decline in prices of stocks and shares. This finds confirmation in historical observations: when a generation from demographic bulge reaches retirement age, i.e. the biggest number of saving people, there is always a rapid decline in the prices of assets. This process is to start about 2030 and it will not be so dynamic in any other region of the world (see Figure 1).

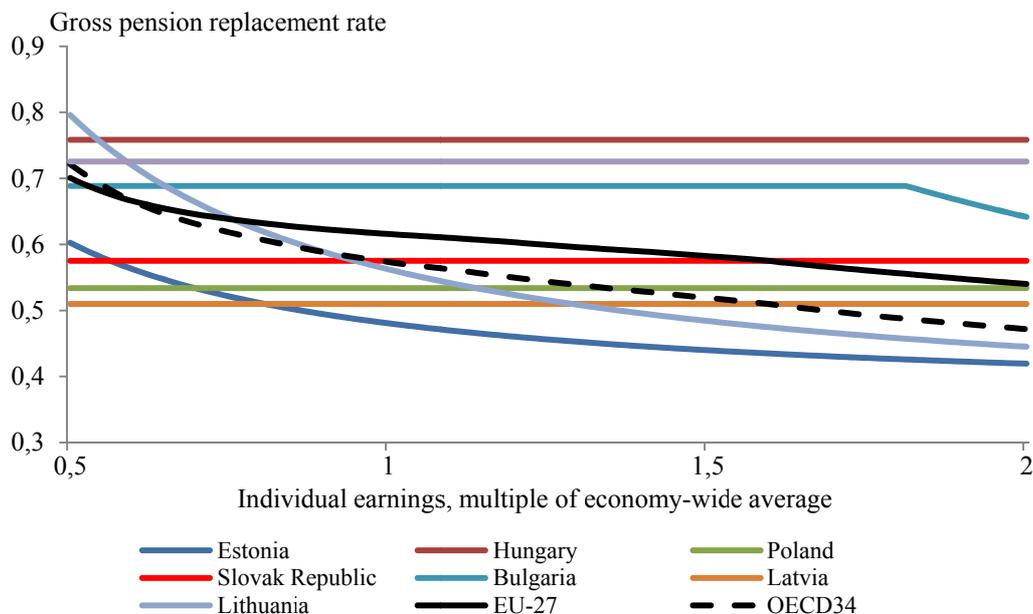
Figure 1. The ratio of the saving to not saving (regional perspective) in 1950-2050



Source: Holzmann R. (Ed.) (2009).

These tendencies changing the population cause problems with securing long-term financial stability of the pension plan and keeping replacement rates on the current level. Gross pension replacement rate, i.e. the value of the pension relative to individual earnings, is a basic parameter which indicates the differences between pension schemes in particular countries. Taking into consideration all OECD and UE27 countries, the replacement rate from the mandatory part of pension scheme in the case of people earning half of the average income amounts to a little over 70% and lowers with the growth of individual salaries, which results from the redistributability of numerous pension schemes. Gross replacement rates for selected CEE countries from the mandatory part of the pension scheme are presented in Figure 2.

Figure 2. Gross replacement rates by earnings in the selected CEE countries



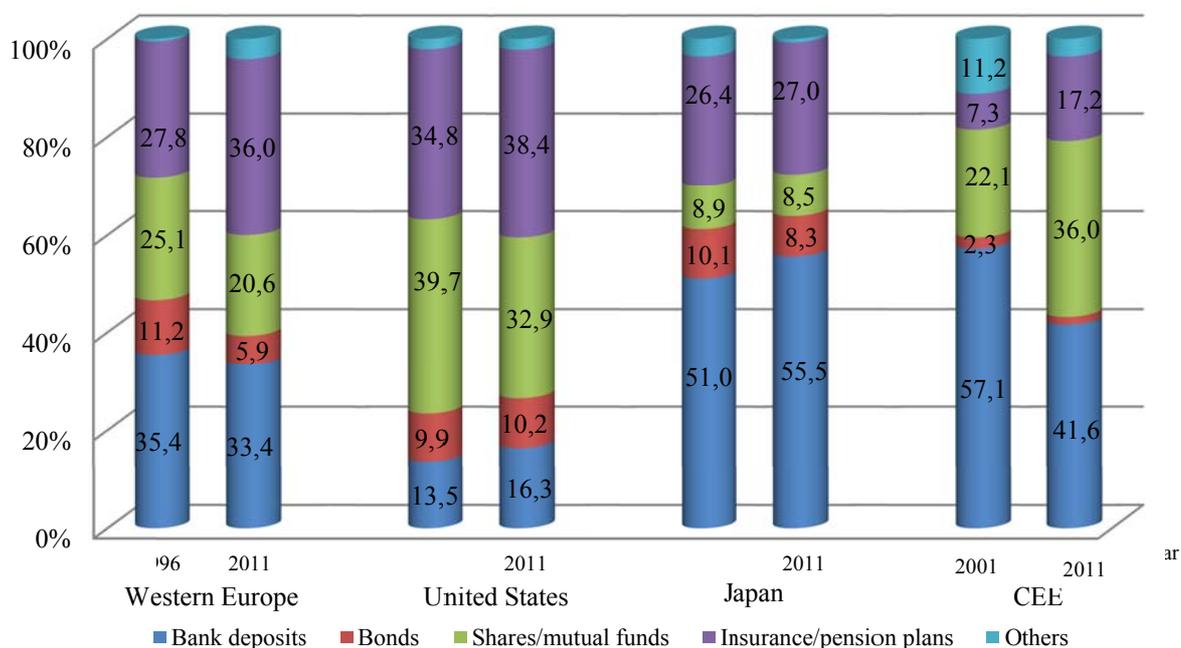
Source: Own elaboration based on OECD, 2012.

As one can conclude from the data presented in the figure, only in three countries, i.e. Bulgaria, Hungary and Romania, the replacement rate for each income level exceeds the average replacement rate for all OECD and EU countries. In the case of Poland and Slovakia, it is below the average of OECD and EU countries for people with low income and over the average for people with high income. Also, it must be observed that in the case of Poland and Slovakia, pension reforms, which took place in 1999 and 2005, brought a decline in replacement rates for people with low income, which in turn had a positive effect for people with higher income causing that, particularly in Slovakia, people with income amounting to 150% of the average monthly income in the country could expect replacement rates higher by 23.3% (from 34% to 57%). This tendency is reversed to the majority of OECD countries, where in countries like France, Sweden, Norway or Great Britain the focus was on people with lower incomes (Whitehouse, 2009).

According to the calculations of the European Commission, gross average replacement ratio<sup>2</sup> from the system of public pension in UE-27 countries in 2010-2050 will be lowered by 20%. This phenomenon, except for Hungary (+6%), will appear with different force in all CEE countries. The decline will amount to 10% in Czech Republic, Bulgaria, Lithuania and Slovenia, to 30-50% in Romania and Slovakia, to 62% in Poland and 68% in Latvia (*The 2012 Ageing...* 2012). Therefore, it is essential to undertake steps in order to increase the significance of additional pension schemes in securing income for the old age so that the adequacy of the pension scheme is improved and state expenditures on pensions are lower.

It should be noted that from the macroeconomic perspective, in the past decade of the 21 century in CEE the interest of society in additional pension saving was significantly greater. Over a decade after the introduction of new pension schemes in CEE countries, the structure of assets gathering for households started to change. There is a growing amount of assets collected in insurance companies and private pension funds in the structure of financial wallet of households. Though in CEE countries it is on lower level (17,2% in 2011) than in Western Europe (36,0% in 2011) (Figure 3), the dynamics of this growth over the last years is the highest in CEE countries, which results from the fact that pension reforms introduced in the last decades led to creation of capital pension funds in the second and third pillar.

Figure 3. Structure of assets in particular regions of the world



Source: Own elaboration based on *Allianz Demographic...* 2013.

<sup>2</sup> Calculated as the ratio of the first pension to the average income in the economy.

### 3. THE CONDITION AND GENERAL RULES OF FUNCTIONING OF ADDITIONAL PENSION SCHEMES

Till the beginning of the 90s, private pension schemes played an important role only in such countries as Denmark, Ireland, Holland, Sweden and Great Britain, where the public system offered minimal benefits and therefore the society was "forced" to become interested in additional forms of saving for the old age (*Private pension schemes...* 2009). Currently many countries around the world concentrate on empowering the sector of additional private pensions having in mind that in the OECD zone the replacement rate for a person with average income from the public part amounts to 42%, and with benefits from the second pillar, i.e. private mandatory pension funds to 57%. Having an additional dedicated pension scheme raises this rate to 64%. Among OECD member states, the replacement rate from voluntary pension plans of DC type (functioning in this form only in CEE countries) is the highest in the USA (38,8%), Ireland (37,6%), Great Britain (36,7%) and Canada (30,8%) (OECD, 2011). Among CEE countries which are members of OECD, the replacement rate is the highest in Czech Republic (11,3%). Generally it may be observed that in the case of functioning of voluntary system of occupational and individual pension plans, occupational plans seem to be more popular yet they do not function in all countries, for instance in Czech Republic.

Until 2007 all of the analyzed countries introduced additional voluntary pension plans. The first were Bulgaria, Czech Republic and Hungary. Very frequently they started functioning before the introduction of mandatory private pension in the second pillar. Regulations concerning their activity in particular countries are similar. These programs act on the basis of defined contribution and their participants may benefit from tax exemptions and sometimes certain state subsidies. The structure and taxation rules of additional pension plans in selected CEE countries are presented in Table 1.

Table 1. Structure and taxation of additional pension schemes in selected CEE countries

Country	The year of introduction	Provision (private)	Coverage	Type	Function (insurance)	Financing (voluntary contributions)	Taxation			Lump sum payments possible in retirement	
							Contributions	Investments (capital gains)	Benefits		
Bulgaria	1994	X	Voluntary	FDC	X	X	E	E	T	Yes	
Croatia	2002	X	Voluntary	FDC	X	X	E	E	T	Yes	
The Czech Republic	1994	X	Voluntary	FDC	X	X	E	E	T	Yes	
Hungary	1994	X	Voluntary	FDC	X	X	E	E	E	Yes	
Poland	1999 (PPE)* 2004 (IKE)*	X	Voluntary	FDC	X	X	IKE, PPE	T	E	E	Yes
	2012 (IKZE)**						IKZE	E	E	T	
Romania	2007	X	Voluntary	FDC	X	X	E	E	T	Regulations on benefits does not exist yet	
The Slovak Republic	1997	X	Voluntary	FDC	X	X	E	T	T	Yes	
Slovenia	2000	X	Voluntary	FDC	X	X	E	E	T	Yes	

„X” – means that the system functions in this way in this country

\* Individual Retirement Accounts, Occupational Pension Schemes

\*\* Individual Pension Insurance Accounts

Source: own elaboration based on (Holzmann, Guven, 2009).

In general all of the analyzed countries use tax exemption on the stage of contributions paid to the program (except for Poland in the case of Individual Retirement Accounts - pl. IKE and Occupational Pension Schemes - pl. PPE) and investment profits (excluding Slovakia). If one considers Poland (including IKE and PPE) and Hungary, benefits paid out are tax-free. Generally, in all countries employers who pay contributions for their workers are allowed to deduct contributions from income subjected to enterprise taxation (does not concern Croatia), there is a minimum age requirement for participation in any pension program (except for Bulgaria and Croatia), participant must reach certain age to be entitled for benefits (excluding Hungary), which can be paid out in the form of a lump-sum of money. The general characteristics

of the system of voluntary private pension insurance in selected CEE countries (without Czech Republic) where it is the most developed is presented in the table below. The Czech system is characterized further in the present paper.

Table 2. General characteristics of the voluntary system of additional pension saving in selected CEE countries

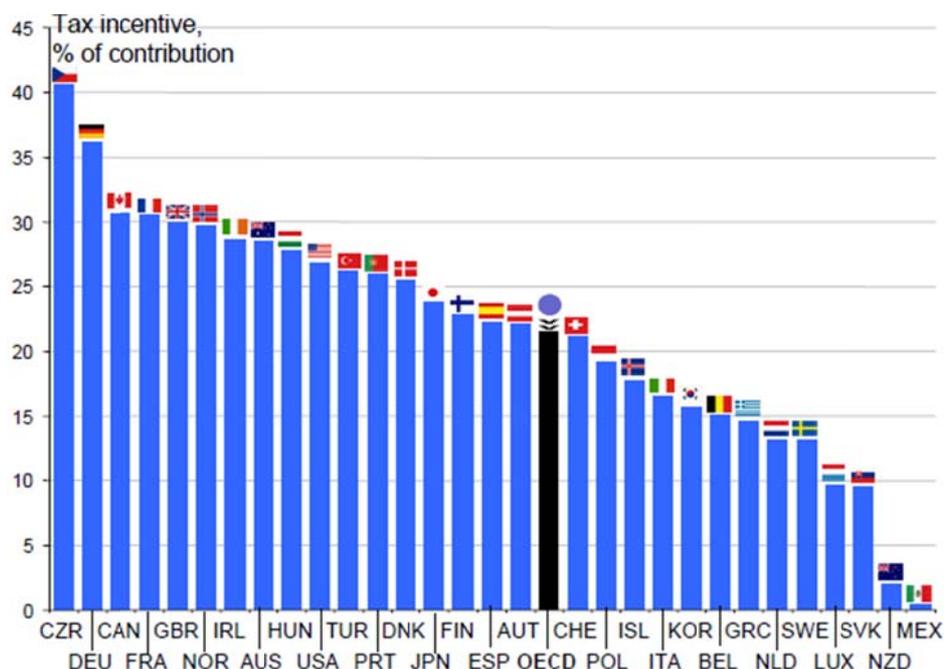
<b>BULGARIA</b>
<p>Participation in voluntary private pension funds (VPFs) is possible for people over 16; benefits are paid out to men who are over 58 and women over 55; minimum monthly contributions amount to 10% of the minimum salary in the country economy. In 2006, eight pension fund management companies operated in the market. Within individual plans 557 thousand people are saving for the old age (10,3% of Bulgaria's working age population) and their assets amount to about EUR 253 million (2006). Voluntary occupational pension plans (OPFs) have functioned since 2007, they provide contributions in the form of fixed-term pensions, lump-sum payments or phased withdrawals to participants when they reach age of 60. These programs are not popular in Bulgaria (around 192 800 participants, the value of assets reaches about EUR 161 mln in 2006). Taxation regulations of occupational and individual plans are the same. Contributions to 10% are excluded from personal income tax, the same concerns employer contributions.</p>
<b>CROATIA</b>
<p>Programs offered by voluntary pension funds may be initiated by trade unions or employers. Funds accumulating in the individual accounts are invested by pension fund management companies. One may distinguish open funds (which operate with no restrictions on membership) and closed (with such restrictions). In mid 2008, in 6 open funds about 117 thousand people saved for the additional pension (assets reaching 727 mln HR, i.e. 0,3% GDP), whereas in 13 closed funds about 15 thousand people (with assets reaching about 128 mln HRK, i.e. 0,05% GDP). In total the participants of voluntary pension funds constituted about 8% of the working-age population. The state subsidizes annually up to 1 250 HRK and allows for tax exemptions of paid contributions up to 1 050 HRK per month. Employer contributions cannot use tax exemptions and the benefits are paid out in the form of annual or periodical payments.</p>
<b>HUNGARY</b>
<p>Contributions to voluntary pension plans functioning since 1994 may come from employers and workers. The state allowed employers to deduct contributions for voluntary pension funds from their tax base. In 2009, the maximum tax deduction amount was lowered to 50% of the minimum wage per employee. Furthermore, the Government introduced a 25% tax on the pension contributions paid by individuals on 2010. Benefits are paid out after at least 10-year period of paying contributions (there is no set retirement age). 30% of the contributions (employer and employee) paid to the plan employees can deduct from their tax base, yet there is a maximum sum of tax deduction at the level 100 thousand HUF. In 2007 there functioned 69 additional pension funds where the participants were 19% of people in working age and about 31% of labor force. Benefits can be collected in the form of a lump-sum payment or as an annuity or be spread over a pre-specified period in retirement. In 2006, benefits totaled Ft 29.2 billion. Though over years the number of Hungarian people participating in the market of voluntary pension plans significantly increased, the value of assets collected by them remains on a relatively low level (756 billion HUF in 2009). In 2006 the state introduced voluntary individual investment accounts (NYESZ), run by banks or brokerage houses. Initially the government expected interest reaching 700 000 accounts, nonetheless, after the first year their number reached only 10 000.</p>

<b>POLAND</b>
<p>Voluntary saving for pension in Poland has individual form, as individual pension accounts (IKE, since 2004) and individual pension security accounts (IKZE, since 2012) as well as group form, i.e. occupational pension schemes (PPE, since 1999). Basic contribution for PPE is paid by the employer and it amounts to not more than 7% of gross income (excluded from the social insurance basis). Employee can pay an extra contribution which doesn't exceed 4,5 multiple of average forecasted monthly salary in the state economy. Currently PPE runs only 0,03% companies, and 2,1% people in working age participate in them. IKE and IKZE are different with regard to taxation rules. While IKE contributions are subject to taxation and the benefit is tax-free, it is the opposite in IKZE. One can deduct from tax basis contributions to IKZE (up to 4% of gross salary, not more than 4 231,20 zł in 2013) and the benefit after ending the period of pension saving or its transfer for the person entitled in case of death of the recipient will be subject to taxation. The limit of contributions for IKE in 2013 is 11 139 zł (three multiple of average monthly salary). In mid 2012 IKE had 5,1% and IKZE 1,9% of people in working age.</p>
<b>ROMANIA</b>
<p>Participation in voluntary pension funds functioning since 2004 is not related to employment, but the contributions paid to the plan may be divided into the worker and employer. Contributions cannot be higher than 15% of the gross income of the employee and the benefits from the plan are paid out after reaching 60 years of age and at least 90 months of paying contributions. Employer and employee contributions are tax-deductible up to EUR 400 a year, investment income is tax-exempt and benefits are subject to standard taxation. According to the state at the end of 2012, 3% of people in working age participated in the plans (0,3 mln), the net assets totaled 0,6 bln RON (0,14 billion EUR), which constituted 0,1% of GDP.</p>
<b>THE SLOVAK REPUBLIC</b>
<p>Voluntary pension funds have been functioning since 1997 (the system underwent reforms in 2004) and about 18% of people in working age participate in them. Collected assets reached 635 million EUR (about 1% GDP). Until 2004 participation in the third pillar was possible only if one was employed, currently the only requirement is that one is over 18. Retirement age was set at the age of 55, benefits are paid out after 10 years of paying contributions. Contributions paid by employees are tax-deductible from tax base up to 323 EUR annually whereas employers may deduct up to 6% of salary for contributions paid for the employee. The income from investment is subject to flat income tax of 19%.</p>
<b>SLOVENIA</b>
<p>The market is served by mutual funds, pension fund companies and insurance companies. Slovenia is the only country in CEE where the market of voluntary occupational pension schemes is functioning on a big scale. Setting up occupational plans is mandatory in the public service and banking sectors as well as for particularly hazardous occupations. Employer may create such a program on condition that 2/3 of the staff take part in it. Employer's contribution usually amounts to 3% of the salary of the employee, and over 430 thousand people participate in these programs, which makes up 52% of the insured in the first pay-as-you-go pension scheme. In the market of voluntary pensions savings in the third pillar there are only about 3,5% of the insured. Voluntary personal and occupational plans are taxed according to the EET principle: employers and employees have joint tax relief up to a maximum of EUR 2,390 (2009). Up to this limit, contributions are tax-exempt, as are investment earnings. Pensions in payment are subject to ordinary income tax rules.</p>

*Source:* Own elaboration based on (Holzmann, Guven, 2009), Hirose (2011), (*Central and Eastern European...* 2007), (*Private Pensions Quarterly...* 2013).

As presented in the table, one may conclude that among analyzed CEE countries Polish and Romanian society are participating in the market of voluntary pension programs to the smallest extent. The opposite phenomenon is observed in Czech Republic, where in 2010 about 61,2% of people in working age took part in individual pension programs, which is the highest rate among OECD countries, despite the fact that there are very specific pension products like KiwiSaver in New Zealand or „Riester Rente” in Germany. Apart from Czech Republic, private pension saving is common in New Zealand (55,5%), Iceland (42,0%) and Germany (36,9%). Nonetheless, it needs to be stressed that Czech Republic have relatively the highest tax incentives in the branch of additional pension products in the world.

Figure 4. Scale of tax incentives to additional voluntary pension products in OECD countries



Source: (Whitehouse, 2006)

The Czech market of private pension plans has been developing very dynamically from the very beginning when a range of incentives to additional pension saving in the third pillar, such as deducting contributions from tax and matching subsidies, where every set percentage of income paid to the plan is subsidized by the employer (or the state), were introduced. Such actions brought an increase in the number of participants from 3,5% to 57% of labor force. The sum of state subsidies to the program is regressive and reaches 50% - 30% respectively to the contribution paid annually. The maximum monthly sum of subsidy is 150 CZK with a contribution exceeding 500 CZK. Moreover, annual contributions paid to the program which exceed 6 000 CZK but under 12 000 CZK are tax-deductible. Taking into consideration the changes in the Czech pension security plan, at the beginning of 2013 the nine existing pension funds were closed for new participants, which caused that in the last quarter of 2012 there was a significant increase in the number of new accounts created to use its guarantees and, consequently, at the end of 2012 the number of participants of additional pension plans was over 5 mln. Accordingly, new participant funds in the third pillar and voluntary capital pension funds in the so far non-functioning second pillar were set up. These funds are supported with 3% of the contribution which so far was transferred as a whole to the first pay-as-you-go pillar and in 2% as a contribution deducted from the participant's income.

Even though the number of Czech people participating in the voluntary third pillar is the highest not only among CEE countries, but in the world as well, and further reforms aim at making it even more common, there are voices<sup>3</sup> that the time of these changes is not appropriate. The Czech economy is developing slowly in comparison to other economies in the region, which results from the fiscal policy geared toward reducing the public budget deficit. As a result, higher public expenditures in the form of subsidies to private pensions may be compensated by higher rates of value-added tax and lower indexation of public pensions.

<sup>3</sup> See: V. Jaroslav, *Czech Pension Reform: What Further?*, [http://www.vsfz.cz/prilohy/konference/vostatek\\_czech\\_pension\\_reform\\_2012.pdf](http://www.vsfz.cz/prilohy/konference/vostatek_czech_pension_reform_2012.pdf).

#### 4. DIAGNOSIS OF THE REASONS BEHIND LOW INTEREST IN VOLUNTARY SAVING FOR THE OLD AGE

In order to diagnose the reasons why citizens of CEE countries do not commonly participate in the system of voluntary pension plans, one needs to provide the results of the latest report of Erste Group<sup>4</sup>. According to the report, lack of activity in saving is connected mainly with the current financial situation of the region. What is important, saving is important for over 3/4 of the people living in the region and it is definitely more significant than in the past. This concerns such countries as Hungary, Poland and Romania. On the other hand, the need to save is the lowest among the citizens of Slovak Republic and Czech Republic. The average sums of money which are saved are evidently lower in Romania (29 EUR per month), than among leading Poles (90 EUR monthly), the Slovaks (83 EUR monthly) and Czechs (78 EUR monthly). However, it needs to be stressed that among citizens of selected CEE countries, only about 25% are happy with the money that they can save, the most satisfied are Czech people (37%). In contrast, in Germany this is about 50% and in Austria about 55%. It is important to define the aim of saving. With respect to that, in all selected CEE countries the aim was to collect funds in the case of unexpected costs (especially in Czech Republic, Slovakia, Turkey and Poland), whereas saving for the old age was of rather varied importance, for example 43% in Poland, 48% in Romania to 71% in Czech Republic. In the case of Czech Republic, the research results of Erste Group are reflected in OECD statistics, which show that Czech Republic has the highest number of people voluntarily and additionally saving for the future pension.

Another reason, excluding insufficient income levels, of not saving for the old age lies in inappropriate financial education concerning its aims and effective forms of saving. It is worth noting that almost 3/4 of the inhabitants of CEE countries claim that their knowledge regarding economy and finances is too low (particularly among Poles and Romanian people). It turns out that education within this respect should start as early as possible, possibly in primary school (Czech and Slovak citizens claim so - almost 70%). According to Erste Group research results, banks ought to play a significant role in this process, which is stressed by mainly Poles. This result reflects the level of trust of the Polish society to banking system in Poland. According to "Social Diagnosis 2011" (*Diagnoza społeczna... 2011*) researching the conditions and life quality of Poles, the biggest trust has the National Bank of Poland (pl. Narodowy Bank Polski - 73,7%) and commercial banks (40,9%). The lowest trust Poles have for the stock exchange (19,5%) and mandatory open pension funds (21,7%).

Common policy supporting additional saving for the old age includes creation of proper tax incentives which are not always effective. There are various solutions where taxation may appear on three levels: contributions paid to the program (1), investment profits (2) and/or when benefits are paid out from the private pension plan (3). Having these solutions in mind, one may distinguish the following tax regimes: EET (exempt-exempt-tax), TEE (tax-exempt-exempt), TTE (tax-tax-exempt), ETT (exempt-tax-tax)<sup>5</sup>. The most frequently used form, also visible in CEE countries, is based on exempting contributions paid to the plan from tax base, tax exemption from investment profits and taxation of benefits paid out (i.e. exempt-exempt-tax EET). This solution, however, is more beneficial for those who earn more and pay higher taxes as they receive better tax incentives to additional pension saving. An alternative form of tax incentives for the saving in additional pension plan is the so-called tax credit, where after calculating the income subject to taxation with appropriate tax rate, one may use tax deduction due on for instance set, permanent level for all taxpayers or in set percentage. According to OECD analyses, thanks to tax credit, contrary to deducting contributions from tax base (tax deductions), one may increase the popularity of participation in additional pension plans among people with low and average income. Nevertheless, there are doubts whether such people will have the possibility to deduct contributions whatsoever (*OECD Pensions Outlook... 2012*). Antolin and Whitehouse stress that it is possible to create the system of tax incentives which would be beneficial for all participants by limiting the tax exemption to the lower or standard rate of income tax (Antolin, Whitehouse, 2009). Another way is using the aforementioned matching contributions. This solution, apart from Czech Republic, is popular particularly in the developed economies, such as the USA (in plans "401k"), in Germany ("Riester-Rente") and in New Zealand (in plans "Kiwi Saver") (Holzmann 2012), i.e. countries which have a well-developed system of voluntary additional saving for future pension.

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<sup>4</sup> Erste Group (2012), *The savings behavior country overview*, IMAS International, September 2012.

<sup>5</sup> For more see: (Whitehouse, 1998); (Whitehouse, 2005).

## 5. CONCLUSIONS

In order to adapt pension systems to actual demographic trends, many countries around the world, including Central and Eastern Europe, reduce benefits from public pay-as-you-go system of pensions and put the burden of collecting sufficient financial resources for the old age on citizens through creation of the system of additional voluntary pension plans. The results of the research indicate that the only CEE country with a well-developed system of voluntary saving for future pension is Czech Republic, which has overtaken even such countries as the USA, Great Britain, Canada, New Zealand - countries which have a big number of citizens saving for the old age and offer a wide range of state incentives supporting the process of saving. To change the attitude of future pensioners, there needs to be a mutual cooperation of the government, providers of pension plans and the future pensioners themselves since even with insufficient income it is essential to be systematic and save in the long-term perspective. Consequently, the sum of money saved for the future pension will be relatively low in relation to the replacement rate. Therefore, there is a need for proper economic and financial education, which according to the research results, is insufficient in the countries of Central and Eastern Europe.

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# **THE INTEREST RATE PASS-THROUGH IN ALBANIA: FROM POLICY RATE TO WHOLESALE INTEREST RATES AND TO RETAIL MARKET RATES<sup>1</sup>**

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## **ABSTRACT**

This study tries to empirically investigate the interest rate pass-through in the case of Albania over the period 2006m01: 2013m12. Using Vector Error Correction Mechanism (VECM), we estimate the transmission of the monetary policy rate to wholesale interest rates (interbank interest rates and T-bills' yields) and then to retail interest rates (deposit and lending interest rates). The methodology employed (VECM) allows to study the short-run and long-run dynamics of the interest rate pass-through as well as the speed of adjustment towards the long-run equilibrium. Also, the study divides the sample into two subsamples, namely the pre-crisis period (2006m01:2008m09) and post-crisis period (2008m10: 2013m03), in order to check for the effect of recent financial crisis on the interest rate pass through over time. The study finds cointegrating relationships between monetary policy rate and wholesale and retail rates mostly when the entire sample is considered, though most of these relationships break down in the pre-crisis period, due to limited observations. Also, when the entire and post-crisis period are considered, retail interest rates (lending and deposits) are cointegrated with interbank interest and T-bills' yields. The long-run coefficients in all found cointegrating relationships are statistically significant, while the immediate response is mostly insignificant and of unexpected sign. This paper might be very useful in determining the efficiency of the monetary policy transmission mechanism.

## **KEYWORDS**

Interest rate pass through, VECM methodology.

## **JEL CLASSIFICATION CODES**

C10, E43, E52

## **1. INTRODUCTION**

Studying the monetary policy transmission mechanism is of high importance for economists, and especially for central bankers. Knowing the magnitude, direction and the time span of monetary policy effects is crucial in designing and conducting sound monetary policies. Mishkin (1996) overviews the transmission mechanism of monetary policy, by discussing its main channels: interest rate channel, asset price channels (exchange rate, equity prices, housing and lending prices) and credit channel (bank lending and balance sheet). As Mishkin (1996) argues, studying monetary transmission mechanism helps monetary policymakers to better understand their policies and provides to them guidance on how to conduct policy while avoiding past mistakes.

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<sup>1</sup> Views expressed herein are those of the author and do not necessarily represent those of European University of Tirana.

The Bank of Albania (BoA) is the institution entrusted by law to ensure price stability in our country, which in quantitative terms is translated as maintaining an annual inflation rate at a numerical point of 3%, with a tolerance band of +/- 1 percentage point. This specification aims to guide the public's inflation expectations and strengthen the Bank of Albania's commitment to achieving this target<sup>2</sup>. The main instrument BoA uses to maintain price stability is the repurchase agreement rate (repo) which is used in open market operations. Repo was introduced in the second half of 2000, and replaced the direct instruments used prior to this year, which consisted in controls on the interest rates of 3-, 6-, and 12-month deposits of state banks. However, BoA retains other instruments which it can use in case open market operations fail to achieve the desired results, like: reserve requirements and standing facilities operations. Since 2006, Bank of Albania follows an implicit inflation targeting regime.

There have been several prior studies which try to investigate the monetary policy transmission mechanism in Albania. So, Kolasi et al. (2010) by using a Structural Vector Autoregressive approach estimate the importance and effect of different channels of monetary transmission mechanism mainly on real economy indicators. When estimating the interest rate channel in the case of Albania, Kolasi et al. (2010) estimate the impact of a change in monetary policy rate on M3, inflation, exchange rate and gross domestic product. Also, Vika (2007) tries to find empirical evidence on the credit channel of the monetary policy transmission in Albania, using individual data of 12 commercial banks. More specifically, this study, employing a GMM (Generalised Method of Moments) approach, aims to estimate how credit to private sector reacts to changes in the monetary policy rate. However, these studies miss the first block of the monetary policy transmission mechanism which is the pass-through from monetary policy rates to interbank interest rates and then to retail rates. To our best knowledge, there is no empirical work on the monetary policy interest rate pass-through in the case of Albania. It is important to study the interest rate pass-through, since its magnitude and speed will determine the efficiency of transmission mechanism. Therefore, this study tries to fill this gap in the existing literature regarding the monetary policy transmission mechanism in Albania.

Empirical literature on the interest pass-through is quite diverse and sometimes contradictory depending on periods, markets, maturities of interest rates, and countries or panel of countries considered for the study. However most of literature employs Vector Error Correction Mechanism to study the pass-through from interest rates to wholesale and then to retail market interest rates.

Kovanen (2011) investigates the interest rate pass-through in Ghana using time-specific data over the period 2005-2010. Based on the VECM methodology, more specifically this study aims to estimate the transmission of changes in the monetary policy base rate to wholesale interest rates (presented by interbank short-term money and T-bills interest rates) and the transmission to retail interest rates (deposit and lending rates). The methodology employed allows studying both, the short- and long-run dynamics of the interest rate pass through, with a special focus on the asymmetry of such pass-through. Main findings of the study suggest that the short-term response of interbank and T-bills interest rates is significantly strong, while in the long-run such response is somewhat sluggish. Also, the author finds that credit and interest rates adjust to changes in wholesale interest rates, but at slow pace, mainly due to uncertainty regarding the future course of macroeconomic policies or due to increased risk, as suggest by rising level of non-performing loans.

A similar study is that of Apostoaie<sup>3</sup> which tries to estimate the magnitude and pass-through from monetary policy to interbank and T-bills interest rates, by distinguishing between pre-crisis and post-crisis period in the case of Romania. The data series used are at monthly frequency covering the period 2003-2012. The study concludes that during the pre-crisis period interbank interest rates react slowly to any changes in policy rate. However, in the post-crisis period such pass-through becomes quite "aggressive" reflected in high and immediate responses of interbank interest rates in the short-run and higher than 1 pass-through coefficient in the long-run. The author attributes such overreaction of interbank interest rates to policy rate to several factors, like: shortage of liquidity on the interbank market, deterioration of expectations of the banking system with regard to monetary policy behavior, constraints on the access to long-term funding, etc.

Another study conducted by Oesterreische National Banks (Egert et al., 2006) aims to understand the interest pass-through from policy rate to market rates and then to retail rates, in five Central Eastern European countries (Czech Republic, Hungary, Poland, Slovakia, and Slovenia), using a Vector

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<sup>2</sup> Monetary Policy Document, for 2009-2011,

[http://www.bankofalbania.org/web/Monetary\\_Policy\\_Document\\_for\\_2012\\_2014\\_6346\\_2.php?kc=0,2,9,0,0](http://www.bankofalbania.org/web/Monetary_Policy_Document_for_2012_2014_6346_2.php?kc=0,2,9,0,0)

<sup>3</sup> The interest rate pass-through from policy rate to interbank interest rates in the Romanian financial system

Autoregressive approach. Authors also provide a comparative view by carrying out the same empirical analysis with three euro area countries: Austria, Germany and Spain. Also, Egert et al.(2006) check whether the interest rate pass-through changes over time (by diving the sample into subsamples) and across different segments of the economy (households vs. nonfinancial sector or short-term vs.long-term), and whether such pass-through is symmetric. A main finding of the paper is that there is no pass-through between the policy rate and long-term market rates due to unstable yield curve in CEE-5 countries. However, there is evidence in support of transmission from the key policy rate to long-term lending and deposit rates. Authors have been faced with quite a challenge in finding solid cointegrating relationships making it difficult to track down the whole mechanism of the pass-through (with the exception of Czech Republic and Hungary).

The remainder of the paper is organized as follows. The forth coming section provides an overview and some stylized facts about of the financial system, Albanian economy and the behavior of interest rates (monetary policy rate, interbank rates, T-bills' yields and retail rates) over the period under consideration, 2006M01 : 2013M03. The third section deals with data and methodology employed. It also presents the obtained results for the three samples. The last section concludes and highlights some issues which might need further research.

## 2. AN OVERVIEW OF THE FINANCIAL SYSTEM, INTEREST RATE AND THE ALBANIAN ECONOMY

The Albanian financial system is dominated by the banking sector, which in the last seven years has reached over 82% of the total assets of the financial institutions, whereas the nonbanking sector has a very weak position in this market, reaching an average rate up to 2.2% of the total assets (table 1).

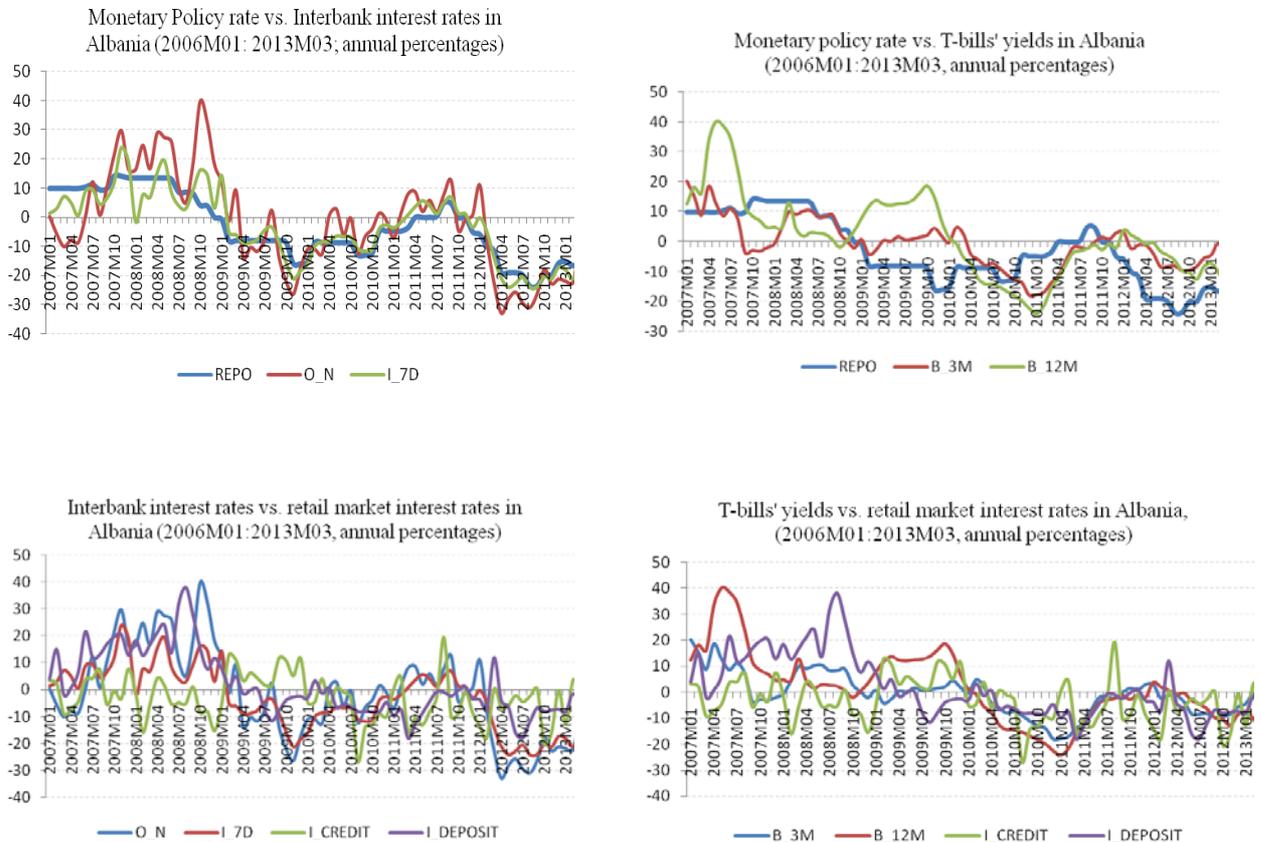
Table 1. Assets of the financial system entities in Albania, as % of GDP through the years.

Licensing and Supervisory Authority	2007	2008	2009	2010	2011	2012H1
Banking System	75.9	76.7	77.5	80.9	84.7	87.2
Non-bank institutions	1.5	1.7	2.2	2.7	2.5	2.5
Savings and loans associations and their unions	0.6	0.7	0.8	0.8	0.7	0.7

*Source:* Financial Stability Report, 2012H1

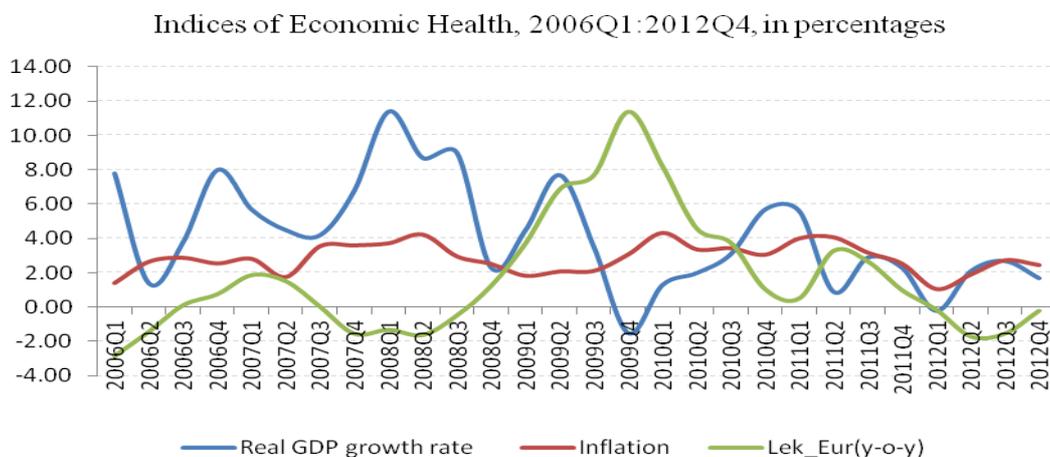
In graph 1 are presented the behaviors of all interest rates used in our study over 2006M01:2013M03. During the period under study (2006M01:2013M03), the behavior of T-bills has been quite volatile. Most of the decrease in T-bills yields during the early part of the period (2007-2008) is due to improved expectations of market agents regarding inflation and monetary policy effectiveness and, also to increased confidence in the reliability of the government to pay back its debt. In more recent years there have been few drastic movements for government yields. The larger movement was an increase during 2009 despite the expansionary monetary policy, as consequence of increased risk perception by banking system during the peak of the global financial crisis. Expansionary monetary policy and a stabilization of liquidity needs by the banking sector would later reverse this effect during 2010. In the coming year (2011), increasing government needs for financing would exert upward pressures on T-bills' yields, which would soon be offset due to monetary policy easing.

Graph 1. The behavior of monetary policy rate, interbank interest rates (overnight and 7-day), T-bills' yields (3- and 12-month); and retail interest rates (lending and deposit rates).



As shown in graph 2, during 2006Q1: 2012Q4, inflation can be seen to fluctuate between the upper and lower bounds that the BoA has set as its targets, respectively 4% and 2%. It is rarely seen to cross these two boundaries. The largest deviation from this pattern was observed in early 2012 where inflation shortly dipped to the lowest rate in almost nine years, a rate of 0.6% in the beginning of the year, because of sluggish GDP growth during that year. However this lasted briefly and returns within the accepted levels was rapid. GDP growth rates during this period were close to 4.5% as an average of all the years, culminating in 2008 with an average growth rate of 7.82%. Using the most recent data, 2012 seems to show the worst growth performance for all the period under consideration, and by some distance. The Albanian Lek has shown to be quite stable during this period, with an average depreciation of 1.6% against Euro. However in the fourth quarter of 2009, lek lost about 10% of value against Euro (7.4% during the entire 2009). However this type of depreciation was common to other developing countries during the crisis, mostly in Eastern Europe, where their currencies depreciated with about 40%. Some of the causes were liquidity flight to countries which were considered safer and reduced remittances due to worsening economic activity and employment situation in countries where most emigrants were hosted.

Graph 2. Main indicators of the Albanian economy.



### 3. DATA, METHODOLOGY AND RESULTS

As already mentioned, this paper tries to investigate whether there is a pass-through from key policy rate to interbank and T-bills interest rates, and then to lending and deposit rates. For this reason, the study uses seven interest rate data series, which are all obtained from the Bank of Albania database: key policy rate (repo), overnight interbank interest rate, 7-day interbank interest rate; 3-month T-bills; 6-month T-bills; lending interest rate; and deposit interest rate (see table 2). All the data are on monthly basis and cover the 2006m01 – 2013m03 period (87 observations).

The interbank interest rates in Albania are on daily basis, but for the purpose of this paper they were converted into monthly frequency as average of daily observations. Other interbank interest rates are those of maturities: 2-weeks, one-month, two-months and three-months, which were not used in this study due to their short time series and to the sporadic nature of interbank transactions for these maturities. Also, it is noteworthy to mention that we choose to represent the retail market by the lending and deposit rates applied to newly extended loans and newly collected deposits, rather than the ones applies to the stock of loans or deposits. The main rationale behind this is that retail interest rates applied to outstanding loans and deposit are expected to react more slowly to any changes in policy rate or interbank interest rate, mainly due to loans/deposits contracts with fixed interest rates.

Table 2. Notation of variables used in the study.

Symbol	Description
repo	Monetary policy rate (repurchase agreement rate)
o_n	Interbank interest rate of overnight maturity
i_7d	Interbank interest rate with maturity of one week
b_3m	3-month T-bills's yields
b_12m	12-month T-bills' yields
i_credit	Average weighted interest rate on newly extended loans
i_deposit	Average weighted interest rate on newly collected deposits

The period under study (2006m01: 2013m03) includes the financial crisis episode as well, which might somehow distort the results obtained on the pass-through of interest rates. Therefore we carry the empirical analysis on the pass-through of interest rate three times: over the entire period (2006m01:2013m03); over the pre-crisis period (2006m01:2008m09); and over the post-crisis period (2008m10:2013m03). Splitting the sample into two subsamples allows not only checking how the interest pass-through in Albania has changed over time, but also whether the financial crisis - although argued to not have deeply affected the Albanian economy and financial system - has had any effect on the pass-through of interest rates. Table 1 in Appendix provides several descriptive statistics for all the variables considered in the study (mean, median, standard deviation, minimum, maximum, skewness, kurtosis, and normality) distinguishing between three samples: the entire period, the pre-crisis period, and the post-crisis period.

Prior to conducting our empirical analysis, based on Vector Error Correction Mechanism, we first employ a simple correlation analysis, which aims to identify the strength of linear association between variables of interest, though not providing any information on the cause-and-effect relationship (Table 3).

Table 3.

a. Correlation analysis between monetary policy rate and the wholesale interest rates and retail interest rates.

Monetary Policy Rate (repo) and the wholesale interest rates	Correlation Coefficients		
	Entire	Pre-crisis	Post-crisis
o_n	0.782	0.683	0.919
i_7d	0.956	0.837	0.983
b_3m	0.810	0.777	0.852
b_12m	0.618	0.831	0.790
i_credit	0.550	-0.255	0.686
i_deposit	0.551	0.761	0.790

b. Correlation analysis between average credit interest rate and the wholesale interest rates.

i_credit	Correlation Coefficients		
	Entire	Pre-crisis	Post-crisis
o_n	0.183	-0.517	0.474
i_7d	0.507	-0.330	0.600
b_3m	0.503	-0.042	0.716
b_12m	0.318	-0.082	0.732

c. Correlation analysis between average deposit interest rate and the wholesale interest rates.

i_deposit	Correlation Coefficients		
	entire	pre-crisis	post-crisis
o_n	0.643	0.730	0.664
i_7d	0.491	0.724	0.733
b_3m	0.603	0.590	0.812
b_12m	0.693	0.649	0.730

As the correlation analysis results show, there is a strong and positive connection between monetary policy rate and the wholesale and retail interest rates– especially with the former, over the three samples. The only exception is the pre-crisis period during which the monetary policy rate and average credit interest rate seem to have moved in opposite directions. Among wholesale interest rates, the monetary policy rate has bigger correlation with interbank interest rates than with T-bill's yields. Also, in the post-crisis sample most of these correlations are higher.

Regarding the second phase of interest rate pass-through (the transmission of changes from wholesale interest rates to retail rates), average interest rates on new credit are negatively correlated with interbank interest rates as well as T-bills' yields, in the pre-crisis period. However in the post-crisis period, these correlation coefficients turn out to be positive. Among the retail interest rates, the ones on newly collected deposits show higher positive correlation with wholesale interest rates, in the three samples.

Most of literature regarding the interest rate pass-through employs the methodology of Vector Error Correction Mechanism, which allows studying both, the short-run and the long-run dynamics of the pass-through. In a very generic form, VECM can be represented as follows:

$$\Delta X_t = \mu + \rho(X_{t-1} - \mu - \beta V_{t-1}) + \sum_{j=1}^k \gamma_j \Delta X_{t-j} + \sum_{j=1}^k \delta_j \Delta V_{t-j} + \varepsilon_t$$

where  $X_t$  denotes variables whose behavior we want to explain are based on its lagged values and other explanatory variables;  $Y$  denotes explanatory variables which influence  $X$  in the long and short-run;  $\rho$  denotes the speed of adjustment of the short-run dynamics to the long-run equilibrium relationship;<sup>4</sup> the expression in the brackets presents the long run relationship between  $X$  and  $Y$ ;  $\beta$  is the long-run coefficient;  $\gamma$  denotes the matrix of short-run coefficients for lagged values of  $X$  till the  $k$ -th lag;  $\delta$  denotes the matrix of short-run coefficients for lagged values of  $Y$  till the  $k$ -th lag;  $\mu$  is the constant term, and  $\varepsilon$  represents the residual term.

If in any of the estimated VECM, the long-run pass-through coefficient,  $\beta$ , equals 1, we can say that there is a complete pass-through between monetary policy rate and wholesale interest rates, or between wholesale interest rate and retail interest rates. A  $\beta$  lower than 1 suggests for an incomplete pass-through, which is often the case given imperfect competition and asymmetry. And if  $\beta$  is greater than one, this is the case of overshooting, which might occur under circumstances of perfect competition.

To study the interest rate pass-through we need to estimate 12 cointegrating relationships. The first four aim to estimate the transmission between policy rate and the four wholesale interest rates, represented by overnight interbank interest rate, one-week interbank interest rate, 3-month T-bills' yield and 12-months T-

<sup>4</sup> Since our data are at monthly frequency, speed of adjustment shows how much of a gap in  $X$  created by a change in  $Y$  is closed within one month.

<sup>5</sup>  $k$  is the appropriate lag length suggested by information criteria AIC and SC criteria.

bills yields. The other eight cointegrating relationships estimate the transmission of each of the wholesale interest rate to retail rates, represented by the credit and deposit rates.<sup>6</sup>

Prior to estimating a Vector Error Mechanism for each transmission, it is crucial to check whether the interest rate time series used in this study are stationary or not. For this reason, we have applied Augmented Dickey Fuller tests on each series for each sample, with and without intercept (Appendix 2). Though literature suggests that most interest time series are expected to be stationary, ADF tests show that all the interest rate data under study are I(1) at 10% confidence level over the three samples, with the exception of credit interest rate which is I(1) at 1% confidence level over the entire sample and at 5% in the other two subsamples (the pre-crisis and the post-crisis period). Despite this we do check whether there is any cointegrating relationship between credit interest rates and the rest of rates over the whole period, 2006M01:2013M03 as well as in the other two subsamples, though the results should be taken with appropriate caution. Following the VECM approach, we obtain the results shown in Tables 4 (a, b and c).

Table 6b presents the results regarding the interest rate pass-through between average credit interest rate and wholesale interest rates. In the second phase of the pass-through, obtained results show that average credit interest rate is cointegrated with interbank and T-bills' yields when the entire sample is considered. To no surprise, the number of cointegrating vectors from credit to wholesale rates is zero, mostly due to data issues: short sample (around 33 observations) and with the time series of credit interest rate being at the border of stationarity even at 1% confidence level. The long-term pass-through from overnight and 7-day interbank interest rate, and from 3- and 12-month T-bills' yields is slightly higher in the post-crisis period than in the entire period. This is due to decreased liquidity in the banking system in the post-crisis period, while the pre-crisis period was mostly characterized by sufficient liquidity surplus. Also, in the post-crisis period banks increased their share of investment in financial instruments to their total assets.

Similarly to the credit interest rate behavior, average deposit interest rate is found not to be linked via a cointegrating vector to any of the wholesale interest rates during the pre-crisis period, due to data issues mentioned above, while in both, the entire and the post-crisis period, the deposit interest rates is cointegrated with all the other rates. The long-run pass-through is found to be statistically significant in both samples, though much lower in the post-crisis period (see Table c).

Table 4.

a. The estimated pass-through from policy rate to interbank interest rates and T-bills' yields.

Monetary Policy Rate (repo) and the wholesale interest rates	Entire sample			Pre-crisis period			Post-crisis period		
	Immediate	Long-term	Speed of adj.	Immediate	Long-term	Speed of adj.	Immediate	Long-term	Speed of adj.
o_n	0.02*	0.90	-0.29	0.03*	0.17	-0.50	0.017*	1.17	-0.04*
i_7d	-0.08*	0.92	-0.65	-	-	-	-0.11*	0.93	-0.48
b_3m	-0.26*	0.59	-0.21	-1.15	0.41	-0.78*	-	-	-
b_12m	-1.63*	1.19	-0.14	-0.42*	0.05*	-0.34	-0.31*	0.64	-0.16
i_credit	-0.23*	0.48	-0.62	-	-	-	-1.34*	1.63	-0.56
i_deposit	0.11*	0.64	-0.19	-	-	-	-0.13*	0.14*	-0.60

\*\*\* Numbers with asterisk are insignificant at 10% confidence level

<sup>6</sup> We run these cointegrating relationships three times: over the entire sample, pre-crisis period, and the post-crisis period. Therefore, in total we have 36 equations.

b. The estimated pass-through from wholesale interest rates to average credit interest rate.

Wholesale interest rates and Average Credit Interest Rate	Entire sample			Pre-crisis period			Post-crisis period		
	Immediate	Long-term	Speed of adj.	Immediate	Long-term	Speed of adj.	Immediate	Long-term	Speed of adj.
o_n	-0.93	0.39	-0.53	-	-	-	-1.55	1.9	-0.19
i_7d	0.07*	1.20	-0.32	-	-	-	-1.27*	1.6	-0.38
b_3m	0.97*	2.00	-0.32	-	-	-	-0.32*	2.03	-0.60
b_12m	0.60*	0.99	-0.24	-	-	-	-0.40*	1.1	-0.62

\*\*\* Numbers with asterisk are insignificant at 10% confidence level

c. The estimated pass-through from wholesale interest rates to average deposit interest rate.

Average Deposit Interest Rate and Wholesale interest rates	Entire sample			Pre-crisis period			Post-crisis period		
	Immediate	Long-term	Speed of adj.	Immediate	Long-term	Speed of adj.	Immediate	Long-term	Speed of adj.
o_n	-0.20	0.77	-0.26	-	-	-	-0.21*	0.67	-0.34
i_7d	-0.21*	1.00	-0.32	-	-	-	-0.08*	0.07*	-0.59
b_3m	0.01*	1.41	-0.24	-	-	-	-0.53*	0.78	-0.82
b_12m	0.07*	0.76	-0.11*	-	-	-	-0.50*	0.39	0.70

\*\*\* Numbers with asterisk are insignificant at 10% confidence level

#### 4. CONCLUSIONS AND FURTHER AREAS OF RESEARCH

To our best knowledge, this study is the first attempt in studying the interest pass-through in the case of Albania, in a two-stage framework. First, we estimate the magnitude and speed of pass-through between policy rate and wholesale interest rates (interbank and T-bills' yields), then we check how the latter transmit to retail markets (credit and deposit interest rate). Some of results are as expected, especially the long-run pass-through coefficients when the three samples are considered, while the short-run responses are of contradictory sign compared to what is expected and most of them are statistically insignificant. We believe this is due to the limited observations included in the pre-crisis sample. In all found cointegrating relationships, the speed of adjustment is statistically significant and varies between 20% and 60%, which indicates that it needs 2 months to 5 months for interest rates to return to their original value after a given shock.

However, we believe there are a number of other areas for further research which might contribute to a better understanding of the interest rate pass-through in Albania. First, it is important to check whether the interest rate pass-through is symmetric or not. Do wholesale interest rates react with the same magnitude to an increase or decrease in monetary policy? Do retail markets react with the same magnitude to increases or decreases in wholesale interest rates? According to Hofman and Mizen (2004), when banks are monopolistic over the pricing of retail interest rates, and changing these prices is costly (as menu costs theory suggests), then banks would be less willing to always adjust their lending and deposit interest rates to any changes in

the policy rate. Also, asymmetry depends on banks' expectations on the future stance of monetary policy. Hofman and Mizen (2004) argue that banks are slower in adjusting their rates to rising rather than to decreasing policy interest rate, since a monetary policy tightening is considered as not fully credible. A simple and quick technique would be to insert a dummy which captures either the increase or the decrease on the interest rates, and based on its sign we can judge on the asymmetry of the pass-through.

Also, a very challenging task would be to incorporate in the model the expected, as well as the unexpected monetary impulses and to check whether interest rate pass-through changes between these two cases.

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## APPENDICES

### APPENDIX 1

Descriptive Statistics on monthly time series for 2006m01:2012m03 (87 observations).

	Mean	Median	Max	Min	Std.Dev	Skewness	Curtosis	Prob. of Jarque Bera
<b>repo</b>	5.27	5.25	6.25	3.75	0.67	-0.40	2.61	0.24
<b>o_n</b>	4.82	4.90	6.66	3.48	0.65	0.05	3.13	0.95
<b>i_7d</b>	5.28	5.27	6.75	3.77	0.64	-0.43	3.12	0.25
<b>b_3m</b>	5.75	5.74	6.45	4.87	0.47	-0.15	1.54	0.02
<b>b_12m</b>	7.71	7.76	9.42	5.72	0.91	-0.10	2.60	0.70
<b>i_credit</b>	12.73	12.83	14.69	9.11	1.20	-0.52	3.03	0.15
<b>i_deposit</b>	4.93	4.94	6.72	3.90	0.55	0.35	3.11	0.42

Descriptive Statistics on monthly time series for 2006m01:2012m03 (33 observations).

	Mean	Median	Maximum	Minimum	Std.Dev	Skewness	Curtosis	Prob. of Jarque Bera
<b>repo</b>	5.65	5.50	6.25	5.00	0.48	0.06	1.52	0.22
<b>o_n</b>	4.84	4.80	5.98	3.87	0.56	0.27	2.37	0.63
<b>i_7d</b>	5.60	5.62	6.23	4.71	0.39	0.00	2.23	0.67
<b>b_3m</b>	5.87	6.00	6.45	4.87	0.45	-0.64	2.10	0.19
<b>b_12m</b>	7.49	7.96	8.26	5.72	0.84	-1.08	2.65	0.04
<b>i_credit</b>	13.28	13.02	14.69	12.25	0.79	0.52	2.01	0.40
<b>i_deposit</b>	5.06	4.91	6.72	4.28	0.62	1.03	3.65	0.13

Descriptive Statistics on monthly time series for 2006m01:2012m03 (54 observations).

	Mean	Median	Maximum	Minimum	Std.Dev	Skewness	Curtosis	Prob. of Jarque Bera
<b>repo</b>	5.04	5.23	6.25	3.75	0.67	-0.22	2.33	0.48
<b>o_n</b>	4.80	4.92	6.66	3.48	0.70	0.01	3.14	0.98
<b>i_7d</b>	5.09	5.18	5.75	3.77	0.69	-0.02	2.87	0.98
<b>b_3m</b>	5.68	5.62	6.37	5.02	0.47	0.13	1.51	0.08
<b>b_12m</b>	7.84	7.68	9.42	6.18	0.93	0.25	1.92	0.20
<b>i_credit</b>	12.30	12.28	14.46	9.11	1.23	-0.27	2.66	0.63
<b>i_deposit</b>	5.05	5.11	5.94	4.15	0.43	-0.22	2.53	0.64

APPENDIX 2

Unit Root Tests for interest rate time series using ADF, in *Levels*

Variables	<i>In Levels</i>					
	<i>entire</i>		<i>pre-crisis</i>		<i>post-crisis</i>	
	<b>with c</b>	<b>without c</b>	<b>with c</b>	<b>without c</b>	<b>with c</b>	<b>without c</b>
<b>repo</b>	0.9951	0.2491	0.8518	0.9973	0.8944	0.6853
<b>o_n</b>	0.2561	0.5254	0.4655	0.8618	0.2296	0.0741
<b>i_7d</b>	0.8595	0.8595	0.3813	0.9803	0.5205	0.0022
<b>b_3m</b>	0.6575	0.5895	0.3752	0.8851	0.8284	0.1285
<b>b_12m</b>	0.3896	0.6053	0.7707	0.7098	0.8807	0.0803
<b>i_credit</b>	0.0180	0.2860	0.0274	0.4736	0.0724	0.2854
<b>i_deposit</b>	0.1308	0.6106	0.8310	0.9740	0.1533	0.3770

Unit Root Tests for interest rate time series using ADF, in *First Difference*

Variables	<i>In first difference</i>					
	<i>entire</i>		<i>pre-crisis</i>		<i>post-crisis</i>	
	<b>with c</b>	<b>without c</b>	<b>with c</b>	<b>without c</b>	<b>with c</b>	<b>without c</b>
<b>repo</b>	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
<b>o_n</b>	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000
<b>i_7d</b>	0.0000	0.0000	0.0002	0.0000	0.0000	0.0000
<b>b_3m</b>	0.0000	0.0000	0.0015	0.0001	0.0000	0.0000
<b>b_12m</b>	0.0000	0.0000	0.0043	0.0003	0.0021	0.0001
<b>i_credit</b>	0.0000	0.0000	0.0012	0.0000	0.0000	0.0000
<b>i_deposit</b>	0.0001	0.0000	0.0003	0.0000	0.0000	0.0000

## **OPERATIVE REGRESSION OR STRATEGIC THINKING – A CRISIS THAT LEADS TO INNOVATION OR STAGNATION**

**This study has been fulfilled within the framework of the project TÁMOP-4.2.2/  
B-10/1-2010-0010 financed by The European Social Fund.**

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### **ABSTRACT**

One of the most popular interesting topics of competitiveness researches is innovation. It is one of the key of business development and stability as the results say. However I was very interested how it starts or blocks in human. Is it a given potential in somebody and it only needs the necessary situation? Is innovation only a question of decision or can we recognize how ability for innovation develops?

Erikson<sup>1</sup> has shown how personality develops during the whole life during typical crisis of the self to solve. Two stages belong to existential life: the professional identity and self-realization. I would like to point out that further stairs can be found within these stages that follow career development along maturing processes. One of them is belonged a quite extraordinary but after all a very common situation as the leader frustrates the professional or strategic role or ambition of the subordinate. As Shepard describes<sup>2</sup> the innovation trials can be blocked in case of too authoriter or overcontrolling leaders. After analyzing the pattern in a quantitative and qualitative research I have found that six possible alternative strategies were used by the people to cope with this frustration. Five of them show different, but practically efficient solutions of the crisis which leads to career development around at middle management level<sup>3</sup>. One of them causes typical stagnation or regression in the frames of the position and blocks the career development. Choosing a way from the first five one, we need to cross the functional borders or confront with and synthesize different interest along the organization which are the necessary psychological skills of innovation. The paper intends to introduce this crisis and describe the possible solutions of it with facts, practical examples. It is a preparing for a further study which can look for correlations between the career development and the chosen coping strategy as a solution trial for the crisis of the given career stair.

The use of this knowledge is manifold. We can identify the focal points of training and development methods such as mentoring. We can define the tools for leaders by understanding the dynamics of how to be able to develop the people. Due to this development we can hope the innovation level, ability and willingness are increasing in a company or a region.

### **KEYWORDS**

Innovation, human resources, coping strategies, career, frustration.

### **JEL CLASSIFICATION CODES**

O15, M51,

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<sup>1</sup> Erikson (1956)

<sup>2</sup> Shepard (1967)

<sup>3</sup> Bognár (2013)

## 1. INTRODUCTION

There are several stairs during the career path<sup>4</sup>. One of them is mostly related to middle management level. The substance of it is that the employee's or oftener the manager's attitude turns from operative, present time problem solving to strategic. The characteristics of the won crisis are: sensitivity to future, extending the influence of future to the present, planning the actions in the perspectives of long term objectives, work out several action plans in case of the planned future shows the alternative face of it. Not rarely people confronts with frustrative, demotivative attitude of the boss or the organization during this career stair. This paper intends to estimate the incidence of this phenomenon, and categorise the possible reactions of the people for this frustration. The study uses a quantitative method to estimate the frequency of occurrence in a multinational FMCG company in Hungary and applies a qualitative interview to map the range of coping strategies. The paper anticipates a further research that could analyse the affect of these personal strategies to the further career development.

Among the possible strategies there are several winning one that provide the improving in positions to turn innovative potential to manifest practice. Excepting one! Unfortunately this one is the most chosen strategy according to the results. All the practical innovations realized by the employees that prefers other coping strategies.

As it is described by McEwen<sup>5</sup> development is a process, as the people become more complex individual. This progress leads through stress. The coping mechanism given to accured challenge could lead to development if the challenge is positively resolved, or in case of negative resolving, the stress, the anxiety could cause regression in development as Chaves described<sup>6</sup>. The progress through necessary crises on the way of personality improvement is documented in Erikson's lifelong development theory<sup>7</sup>. As he explains the not final result of crisis of each stage could lead to further stages in case of winning or regression and not developing to the next level.

The purpose of this paper is to provide a correct description of coping strategies at the deep insight period of career when the possible innovatives arises and try to manifest through professional, communication, cooperation and sometimes scope of authority related challenges.

## 2. METHODS

### 2.1. Pattern, survey, analysis, interview

This study uses a regular satisfaction survey at a multinational FMCG company in Hungary as a quantitative data. The company has around 2000 employee in different premises in the country. The questionnaire has been answered by 1134 respondents. These respondents have been categorized to 5 different position levels which can be interpreted as career stairs likely with different scope of crises and challenges. This study uses only 3 questions from the survey to select the ambitious employees who could be probable frustrated in realizing their profession confronted to more operative or different expectations. This frustration factor was estimated from value of question number 2 subtracted from value of question number 1 and value of question number 3 subtracted from value of the question number 1. We just got an estimated orientation about the repartition of the frustration appeared in the difference between feeling motivated (question number 1) and feeling that the company is not motivative (question number 2) or feeling the authority is not given to the delegated responsibility (question number 3).

I have selected 15 colleauges from each position categories who answered the motivating and the ambitioning questions with the biggest difference. The tested questions were the following:

*Question number 1: I feel motivated to go beyond my formal job responsibilities.*

*Question number 2: My company motivates me to contribute more than is required.*

*Question number 3: I have enough decision-making authority to do my job well.*

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<sup>4</sup> Bognár (2013)

<sup>5</sup> McEwen (1998)

<sup>6</sup> Chaves (2006)

<sup>7</sup> Erikson (1956)

Together with the HR director, we have assumed they had been the most frustrated persons in realizing of professional ambition. These employees (managers and associates) were asked for an optional, confidential interview for a further analysis of satisfaction and displeasures at the company as a qualitative research on frustration. We were collecting the employee's possible coping strategies. Learning on other experiences, we collected the coping strategies answers to frustration.

## 2.2. Hypothesises

There are no more and not less then six possible coping strategies given for frustration.

Table 1. The hypothesed coping strategies:

Number	Strategy
1.	Direct constructive confrontation with the frustrative superior on the purpose of convincing him
2.	Direct destructive confrontation with the acceptance of resignation, as a possible consequence of it
3.	After wearying of the confrontation starting to apply to other companies.
4.	Keeping on the persuading but finding allies or sponsors for the initiatives without direct confrontation
5.	Paralelly living the professional key role in own interest and regressing to operative role in the company's interest. The employee starts to manage his own interest sometimes against the company interests
6.	Regression to operative role and give up initiatives

The 5<sup>th</sup> strategy does not appear without the leader's or the organisation's putative or substantive offence against the partnership.

## 3. RESULTS

### 3.1. Numbers in the pattern

The following questions were analysed from the satisfactionary survey of the company seen in table 1, 2 and table 3. We can see the number of respondants and the summarised score of the answers per position categories.

Table 2. Question number 1: I feel motivated to go beyond my formal job responsibilities.

	Executive (member of board)	Manager of managers	Manager of people	Salaried individual	Hourly individual
Number of respondants	30	162	60	421	429
Summarised score <sup>8</sup>	461	428	421	400	399

<sup>8</sup> Calculated from the percents of responses

Table 3: Question number 2: My company motivates me to contribute more than is required.

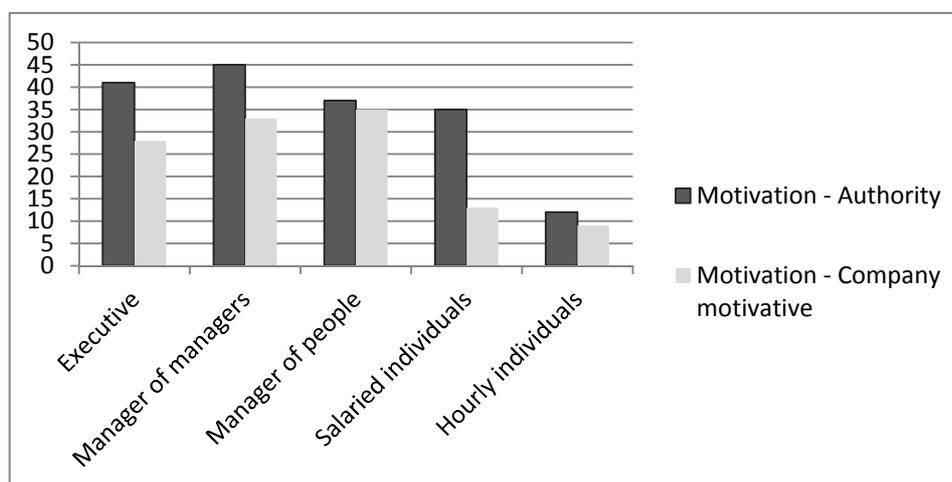
	Executive (member of board)	Manager of managers	Manager of people	Salaried individual	Hourly individual
Number of respondants	30	162	60	422	430
Summarised score <sup>9</sup>	420	383	384	365	387

Table 4. Question number 3: I have enough decision-making authority to do my job well.

	Executive (member of board)	Manager of managers	Manager of people	Salaried individual	Hourly individual
Number of respondants	30	161	61	415	426
Summarised score <sup>10</sup>	433	395	386	387	390

Figure number 1. shows the difference between the summarised scores of feeling motivated for going beyond the formal job responsibility and the feeling that the required authority is enough (dark column); and the difference of the summarised scores of the mentioned motivation and the company's motivative attitude. We have interpreted the higher difference (taller column) as a bigger frustration. This diagram only shows an estimated repartition of frustration among the position categories.

Figure 1. The values of the frustration indicators among position categories



Source: Hay Group (for the company), own calculation

<sup>9</sup> Calculated from the percents of responses

<sup>10</sup> Calculated from the percents of responses

### 3.2. Testing of hypotheses

*There are no more and not less than six possible coping strategies given for frustration.*

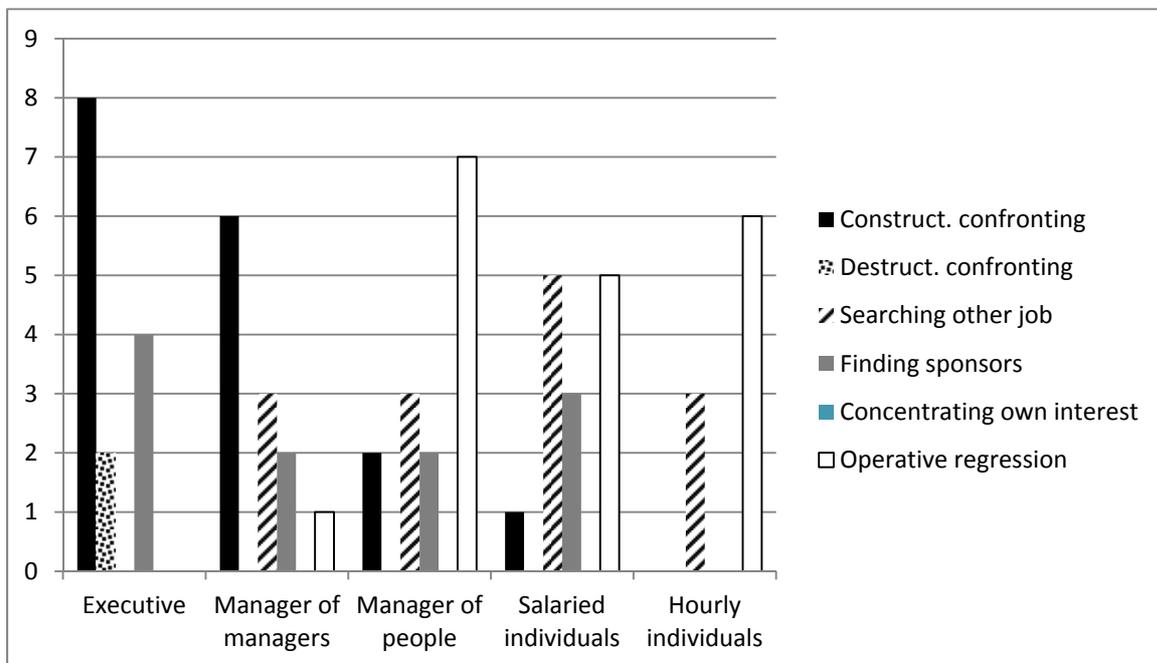
Analysing the results of the personal interviews with 75 people, we have found exactly these five coping strategies explicated under. So the original hypothesis is failed. Due to we have preliminary detected this kind of coping strategy, I don't exclude the opportunity that admitting the give up of the common interest and the commitment to the company in public could be risky, so if there had been any representation of this strategy in this pattern it would have not risen up also due to the presence of HR director on interviews.

*The 5<sup>th</sup> strategy does not appear without the leader's or the organisation's putative or substantive offence against the partnership*

Since we could not detect this coping strategy I cannot test this hypothesis.

The figure number 2 below shows, that the more the position gets higher the more the appearance of constructive confrontation strategy is represented (black columns). The grey columns also indicates that the operative regression is rather rises up among the lower positions.

Figure 2. The representation of coping strategies in position categories



Own source, own calculation

### 3.3. Description of the found coping strategies

Table 5 shows the appearance of the coping strategies in the pattern in numbers.

Table 5. The number of coping strategies among the 15 interview participants per position categories:

	Executive (member of board)	Manager of managers	Manager of people	Salaried individual	Hourly individual
Construct. confronting	8	6	2	1	0
Destruct. confronting	2	0	0	0	0
Searching for other job	0	3	3	5	3
Finding sponsors	4	2	2	3	0
Concentrating own interest	0	0	0	0	0
Operative regression	0	1	7	5	6
Not relevant Without frustration	1	0	1	1	7
Sum:	15	15	15	15	15

*Direct constructive confronting with the frustrative superior on the purpose of convincing him*

According to the respondents it is a stressful period in work. Sometimes they feel their boss incompetent with a high motivum for living his authority. The respondents fights for the acceptance and the trust. They feel they cannot utilise their profession even they have right and reasonable arguments. But they don't give up. Comparing with other coping strategies this one needs the highest power and dominancy.

*Direct but destructive confrontation with the acceptance of resignation as a possible consequence of it*

The employees or manager who chooses this strategy has a high dominancy and a provokable agressivity. It is pairing with the high commitment for the profession. According to the analysis of the answers, the compliance and the professional commitment devide. After the conflict goes to a demagoge

*After wearying of the confrontation starting to apply to other companies*

In this pattern I have found only one occasion for this coping strategy. The employee doesn't give up the fight but realizes that the organisation environment is not fits for his demands. He tries to fight for his right but not just only for the desired achievement, especially the required authority or autonomy. He counts with the possible getting the push. He fights for the moral victory and maybe for the more prosperable exiting conditions. The employee still desires the opportunity for the professional commitment but realises, that it is not possible and he refuses the compromises. He plans to look for other opportunities but still does not give up the fight. The detected emotional regression does not reduce the career ambition and the drive for the development. The employee tries to retain his self esteem.

*Keeping on the persuading but finding allies or sponsors for the initiatives without direct confrontation*

This detected strategy appraised by me the most developed and complex concept. The employee regards the object professional ambition or the innovation idea as a project and he consciously looks for sponsors. This chosen sponsor or sponsors can help confronting instead of him or they can find other alternative ways to realize the idea. The person develops skills for networking and not just among the upper management from

managers can help to persuade the decision makers but also among the co-ordinate colleagues. This kind of coping strategy presumes a popular person who thinks not just directly. He recognises the drives of upper decisions and develops tools to influence these. This strategy has the best prognosis.

*Paralelly living the professional key role in own interest and regressing to operative role in the company's interest. The employee starts to manage his own interest sometimes against the company interests*

We couldn't find example for this coping strategy in this pattern. Since this one has morally querable content as a compliance problem and the HR director cannot undertake a full confidentiality against the company interests, the respondents may have held back information. According to other experience this strategy rises up on the correlation of frustrated ambition and a felt putative or substantive offence against partnership between the leader and the subordinate. Due to this strategy was not detected, the related 2.2.4. hypothesis could not be tested.

*Regression to operative role and give up initiatives*

Considering the possible winning or stagnating progress of crisis, this strategy has the worst prognosis. The employee accepts the applicator role instead of filling the position with the required professional or strategic content. The development stops, the challenging tasks does not brings the hidden potentials to surfaces. In 3 cases the respondents turns to task orientation in the attitude and start to perform low in the position.

#### 4. CONCLUSION

In this study I have focused a career development stair and the related, possible crisis of it. This stair is when the ambition for strategic thinking or the professional performing is high but this drive is frustrated for example because the expectation of the boss is unfairly not strategic but rather operative. The boss sometimes requires exact implementation without added value or "hard to control" extra efforts from the subordinates. This time the subordinates consciously or not, try to cope with the situation. The intention of the paper was to describe the possible coping strategies given to those special circumstances. The study shows that this kind of frustration is most related to middle management (represented in manager of people and manager of managers position categories) which is shown in figure number 1. Each coping strategies can be related to more position categories but there is a trend indicated that there is a difference in the chosen strategies as it seems in figure number 2. The results mean a great output to a further study on the correlation between career development and the given coping strategy. We can set up a hypothesis to a further research, that the operative regression stops the progress of personal profession. For testing this it is necessary to follow up the respondents on their path.

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# **ECONOMIC CRISIS IMPACT ON MARKETING EXPENSES. THE CASE OF THE ALBANIAN BANKING SECTOR**

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## **ABSTRACT**

During the last decade the financial institutions have faced significant changes. Globalization, for instance, has increased the level of competition and the access to information by affecting this way the "loyal customer" of the past years. However, in the business environment of the XXI century, the increase and retention of loyal customers are important factors for long term success. In fact, many companies have shifted their emphasis from winning new customers to retaining existing ones. In such environments, marketing is seen as an essential weapon to their success in the near future.

Thanks to globalization, the economic crisis has been the most debated topic in the recent years, since it has affected many developed and developing economies. Developed countries like the United States of America have suffered bankruptcies of many important companies, they have cut jobs, raised prices, etc. In developing countries like Albania, the effects are felt in foreign investments, prices, income, etc.

During recent years in Albania the relationship between marketing and the banking sector has been very strong as a result of different factors, such as changes in the demographic structure, the intensity of competition in the financial sector, and banks' aim to increase personal benefits. However, marketing function in the banking sector did not consist mainly in the sales of products and services, but was also focused in creating a strong image and personality of the bank in the minds of actual and potential consumers.

The aim of this paper is to explore the impact of the economic crisis in the marketing expenses of the Albanian banking sector. The study takes into consideration the main marketing spenders in the Albanian banking sector, and focuses on their main marketing activities during this period. The result of this study confirms what was previously confirmed, the fact that during economic crises companies tend to mainly reduce their marketing expenses.

## **KEYWORDS**

Marketing; communication; financial institutions; economic crises

## **JEL CLASSIFICATION CODES**

M31; M30; M37

## **1. INTRODUCTION**

The history of the Albanian banking sector can be divided into three phases. The first phase relates to the communism period, up to the early 90s, where the country banks were run by the state (BoA, Insurance Institute, National Commercial Bank, Agricultural Bank); second phase is known as the transition period, until 1997, when the economy passes from centralized to private system. This period is characterized by pyramid schemes, or in other words, the creation and of illegal institutions to deposit money. And the last period of this history has roots from 1997 and up to the present days (Helfat and Lieberman, 2002). During this period there were observed several foreign investment in the country's banking sector, which have helped Albania to return to normal activity and its banking sector to regain the vitality.

Moreover, the last decade has faced financial institutions with the biggest changes that have ever happened in the history of the sector. Globalization has increased the level of competition, the access to information, and

at the same time has vanished the "loyal customer" of the past few years. In such environments, marketing should be considered by these institutions as essential to their future success! More on this, during the last years developed economies have been affected considerably by the latest financial crisis, and due to globalization, the speed of this crises was spread quickly even in the emerging economies. Therefore, the aim of this paper is to explore the impact of the economic crisis in the marketing expenses of the Albanian banking sector. The study takes into consideration the main marketing spenders in the Albanian banking sector, and focuses on their main marketing activities during this period.

## 2. FOREIGN INVESTMENTS IN THE ALBANIAN BANKING SECTOR

According to Whitelock (2002) centralized economies are characterized by a concentration of the business activities in the hands of the state. Significantly, Kawai and Takayasu (2000) point out that one of the most important tools to meet development objectives and achieve macroeconomic stability, are the reforms in the banking and financial sector.

During the last decade, the foreign banks have played a dominant role in the Eastern European countries. These banks have penetrated markets in various forms, opening their own branches, taking part in the privatization of the state-owned banks, through partnership, etc. From an analysis, it was concluded that by the late 2004, Albania was the only country in the Eastern Europe that has attracted the most foreign banks.

Wolf (1999) stated that the process of transition has been quite traumatic for many countries of South Eastern Europe. In the meanwhile though, this period has enabled many foreign businesses to expand their activities in these countries, and at the same time has created to many other entry barriers (Meyer and Jensen, 2004). According to Koch (2001), the presence of foreign banks in the banking system of a country, is an important source for their development.

Table1: Foreign banks proportion in the south eastern countries. In percentage, from 1995-2004.

Countries	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>Bulgaria</b>	7.3	7.1	25.0	50.0	64.7	71.4	74.3	76.5	71.4	68.6
<b>Romania</b>	25.0	25.8	39.4	44.4	55.9	63.6	72.7	77.4	70.0	71.9
<b>Croatia</b>	1.9	6.9	11.5	16.7	24.5	48.8	55.8	50.0	46.3	40.5
<b>Albania</b>	50.0	37.5	33.3	80.0	84.6	92.3	92.3	92.3	86.7	87.5
<b>FYROM</b>	50.0	22.7	9.1	25.0	21.7	31.8	38.1	35.0	38.1	38.1
<b>Serbia &amp; Montenegro</b>	.....	.....	.....	.....	4.0	3.7	14.8	24.0	34.0	25.6

Source: Bank of Albania (2008)

As it can be seen from the above table, at the end of 2004 Albania held the first place for attracting foreign banks in the market, 87.5%. It was followed by Romania with 71.9% and Bulgaria with 68.6%. Croatia and Macedonia had a higher proportion of foreign banks in the country of 40.5% and 38.1% respectively. While Serbia and Montenegro markets were dominated mainly by domestic banks.

According to the experts of this sector, foreign banks presence in the Albanian banking sector was crucial since they played an important role in the modernization of the domestic banking system. However, in the recent years, the banking sector in country is considered the most developed one of the country's financial systems and manages 95.5% of total financial assets. Albanian banking system consists of 16 commercial banks (of these, 3 Albanian banks and 13 foreign / partnership). In general, this market offers similar

products and services and the major players are Raiffeisen Bank, Intesa San Paolo, National Commercial Bank and Tirana Bank.

### 3. THE ROLE OF MARKETING IN THE BANKING SECTOR

Marketing application in the western countries' banking sector has started the 1950, and only after the year 1990 it started to be practiced in Albania. During the years, banks in the country have learned how to implement marketing techniques in the most efficient ways. In fact, good marketing does not happen accidentally, but it is the result of a careful planning and execution. Marketing practices are constantly being improved and adapted to the changes that take place in one industry. As Michael (2008) has pointed out, excellence in marketing is very difficult and rare to achieve!

Bank marketing does not consist only in the sales activities, but in today's competition marketing plays an important role in creating and sustaining a distinctive position of the bank's brand in consumer's perceptions. Marketing importance in the banking sector is increased due to crucial changes that are taking place in the macro environment. Firstly, changes in demographics have a direct affect on people's demand for banking products and services. Secondly, especially in the Albanian banking market, the increased competition from domestic and foreign banks, the entrance of financial institutions operating as non banks (such as, mobile payment providers) and other financial institutions, make the role of marketing and communication department essential for banks. And lastly, banks are in the market to make profits. Therefore, through marketing department banks will have the possibility to create new products and attract new segments of the market that were not attractive before.

Different studies have concluded that one bank profitability and success is closely related to several issues, such as: its marketing staff ability; operation efficiency, and a high risk management. However, achieving a success in the three issues is a difficult task in today's economy. The situation becomes even more complicated in recession periods. Many researchers in this field have suggested that if banks aim to achieve success in the long run, they should be able to adapt their activities quickly both to the changes in: their business environment and consumer behavior.

#### 3.1. Marketing Mix in the Banking Sector

In most of the time, services are considered as intangible goods. In this category there are included different types of industries like: business, communications & Internet, construction & engineering, educational, financial, tourism, transportation, and many others (The Business Link, 2006).

Some of the most common **services** offered by banks are: loans, deposits, money transfer, bill payments, etc. The strategies of these services are the ones that determine the long term success of these institutions (Herrero and Peria, 2004). **Price** is an important component of the marketing mix, and this is one reason why banks should take carefully into consideration the prices for their services and at the same time their pricing policies. Traditionally banks have used three types of price policies: "cost plus", "transaction volume base" and "challenging the leader". **Distribution** is equally important and banks offices in Albania are still using traditional methods in their banking services. **Promotion**, is another important element in the banks marketing mix and it consist in personal selling, advertising, public relations and sales promotion. Different researches have shown that in the XXI what really matters in the market are consumer's perceptions. Therefore, promotion becomes a strategic tool for marketing battle in this market.

#### 3.2. Bank's Products and Services in Albania

During their 10 first years in the market, the banking activity in Albania was mostly focused in the service of saving deposits. However, during the years 2007-2008, it was noticed an increased attention toward marketing activities. And today, banks offer a full range of banking products and services in four main business sectors (private individuals, micro businesses, small businesses and corporate business). Consequently, banks increased their: communication campaigns, the number of products and services offered, and their branches all over the country. According to Bank of Albania (2009), the level of

competition is easily identified from the number of products and services that are being offered by banks, as well as from the costs of production. As previously noted, during the years the number of foreign banks operating in Albania was considerably increased. Being a fast developing country it has attracted many foreign investors, and for this reason banks were mostly focused in promoting their services that will better cover their both, short term financial needs as well as the long term ones, starting with overdrafts and long term loans. In fact, foreign investor's interest in Albania was higher compared with other European countries. But, importantly financial analysts argued that foreign investors will face many difficulties in returning the money borrowed back to the banking institutions, according the promotional schemes that were established by the banks. During the past 8 years, in the market it was observed a high demand for mortgages, with an interest provided by the banks that exceeded 5% per year. After aggressive promotions for mortgage loans, the largest banks began to present loans also for other products, such as holidays, car purchase, household appliances, etc. According to the data from the Bank of Albania, consumer credit market accounts for about 10-13% of the credit market. With regard to this sector, we must first consider the fact that the euro currency has been selected as the main currency for any kind of funding. While loans in local currency (ALL - ALL) account for about 29% of the total portfolio. Banks reported that the types of loans mostly preferred by Albanians were: consumer loans and mortgages.

### **3.3. Communication Campaigns**

During the past years, the usage of marketing communications has changed to something more complex and less vulnerable than it was in the past; this was due to the fact that markets are developing quite fast and the technology is already providing numerous channels of communication and new ways to send messages to the publics. Banking institutions used communication campaigns (which mostly aim to educate the market) to strengthen the image and provide information. The traditional media channels are the most preferred channel from these institutions to advertise, including: newspapers, magazines, radio, and outdoor.

Considering the effectiveness of communication campaigns, in Albania there are two main sectors of the market that invest constantly in these techniques, which are: the telecommunication and banking sector. According to the Albanian Bank Association, the media space between these two big spenders is split as follows:

In 2012, the banking sector approximately was present in the following media with the following percentage:

- 67% in TV advertising
- 17% in Outdoor
- 10% in the print media
- 3% in radio
- 1% in Internet

In 2012, the telecommunication sector approximately was present in the following media with the following percentage:

- 55% in TV advertising
- 25% in Outdoor
- 15% in print media
- 4% in radio
- 1% in the web.

## **4. THE ECONOMIC CRISES**

Until August 2007, it seemed like a good economic period around the world. Economic growth was strong, low inflation rates, international trade was expanding, and developing countries were making significant progress. This situation started to change in the coming years. Initially, real estate values were increasing in many countries, including developed countries like USA. Second, a large number of countries started to experience large budget deficits, including in the list the U.S.A. Global imbalances have been manifested through a substantial increase in the current account deficit of the US mirrored by the substantial surplus in

Asia, particularly in China, and in oil exporting countries in the Middle East and Russia (Lane, 2009). And thirdly, leverage had built up to extraordinary levels in many sectors across the globe, notably among consumers in the United States and Britain and financial entities in many countries.

However, it is important to note that the global imbalance was caused not only by the above factors, but they were among the most important ones. Considering the case of Albania, the global economic crisis had a lower effect in the country. According to the Bank of Albania, the economy grew by around 7 per cent in 2008 and 6 per cent in the first quarter of 2009, driven by public infrastructure investments and activity in the services and telecommunications sectors. The 2008 budget deficit increased to 5.7 per cent, up from 3.5 per cent in 2007, mainly due to an increase in the number and size of infrastructure projects. Revenue administration and public debt management were strengthened, leading to increasing tax revenues in 2008 despite a reduction of corporate and personal income tax rates to 10 per cent. The government debt burden remains high at above 50 per cent of GDP, while external debt is manageable at around 20 per cent of GDP.

The biggest impact of the crisis was felt in the real economy due to lower remittances (a fall of 18 per cent in the first half of 2009 compared with a year earlier) and lower exports (down 17 per cent year on year in the first half of 2009) while imports decreased by less than 2 per cent. As a result, the account deficit continued to remain high at around 15 per cent of GDP. In response to falling foreign currency inflows and tighter lending conditions, the Bank of Albania (BoA) lowered its policy rate from 6.25 to 5.75 per cent in January 2009.

## 5. ALBANIAN BANKING SECTOR DURING ECONOMIC CRISES

Kotler (2009) has suggested that in a dynamic business environment, businesses need to have more flexibility and should adapt very quickly to market changes. Going back to the Albanian banking system, it can be observed a decline in marketing activities during the year 2009. This is shown in a decrease in saving deposit by individual entities.

To overcome this situation and to attract again their target market, first of all, the biggest commercial banks in the country started to increase the interest in saving deposit. However, some banks even exceeded the maximum limit of 8% Albanian Lek or 6% in Euro. Secondly, another important element of their marketing strategy was that of focusing in niche markets. Accordingly, banks started to produce more products and services for emigrants and for their loyal customers (in order to retain them). But, as Bank of Albania reports, threatened from the global economic crises and eager not to lose their market share, commercial banks in the country more than one time have not followed the law and were not transparent to their client. Thirdly, in order to regain their position in the market, all commercial banks in Albania started to engage in communication activities in order to change the perceptions in the minds of consumers as loyal and respectful institutions. In fact, in the following years (from 2009 to 2012), the marketing battle between the institutions in this sector was focused mostly on this marketing tool.

It is important to mention that marketing communication campaigns were strictly built upon communication objectives or upon the budget that was available for promotion. From a close marketing activities observation, it was noticed that in 2012 the five biggest spenders in marketing activities were the following institutions: **Raiffeisen Bank** (which has been for years the biggest spender in marketing activities) with a marketing budget that counted for 658,293 euros. It is followed by **National Commercial Bank (BKT)** with a marketing budget of 590,004 euro; **Alpha Bank** 388,357 euros, **ProCredit Bank** with 260, 189 euro, **Tirana Bank** with 191, 973 euro and **National Bank of Greece** with 111,695 euro. These top five spenders in the banking sector have invest their marketing budget in the following activities: cards, deposit, consumer loans, housing loans, SME, and communication activities.

## 6. CONCLUSIONS

From the above study it was understood that Albania is a country with a not highly developed financial sector. Therefore, during the economic crises it was less exposed to international goods and thus not considerably affected by the economic crises. Even though, during this period it was observed a decline in

the export sector and the global recession had affected considerably the remittances. As a result, during 2009 the country had a lower growth, but not negative.

Despite positive developments in the country, periods of economic crisis intimidate businesses and force them to lower their investments. Market experience has shown that the first areas of cost reduction are the marketing activities. In fact, even today business people have a wrong concept of marketing; while they should consider it as the business's competitive advantage and strongly rely on its ideas and offerings. Therefore, it is suggested to companies to adopt their budgets in crisis situations, as the reduction or elimination of marketing activities means that the company has no place where to generate more sales.

From the observation in the Albanian banking sector during the latest crises, we came to the conclusion that banks have not eliminated the marketing activities from their business strategy. By contrast, their activities were intensified and were focused mainly in educating the market and building strong brand names among consumers.

## 7. RECOMMENDATIONS

Some recommendations for marketers in times of crisis:

- Invest in research and development in order to generate new ideas and create new products and services.
- Identify and start use new communication channels, such as social media.
- Invest in customer relation management.
- Network marketing.

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# **THE ECONOMIC CRISIS THWARTS ALBANIA'S ATTEMPTS TO EMPLOY MODERN POLITICAL MARKETING TECHNIQUES - A CASE STUDY OF THE 2009 PARLIAMENTARY ELECTION CAMPAIGN**

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## **ABSTRACT**

The case study of the 2009 electoral campaign of Parliamentary candidates in Albania reveals that, although attempts were made to employ modern marketing techniques in the political arena, such attempts met with failure, which was largely due to the economic crisis. Attempting to use the U.S. campaign model that relies heavily on technology in order that a candidate's message reach the maximum number of potential voters, candidates were frustrated by the lack of technological capacity that is needed to employ effective marketing techniques in Albania. There are critical signs of decline in the Albanian economy, which seriously limit the availability of funds for a political campaign. Subsequently, the use of political marketing techniques is greatly limited. Television advertising, mailings of campaign literature, among other marketing needs, are too costly to be carried out on a great scale. The use of computers and internet to reach voters is not a viable choice as such technology is not affordable by the population at large. The financial crisis has limited the availability of technology in the Albanian society even more. The financial crisis appears to have hit exceptionally hard in this country, which was making attempts toward Modernization. As early as in the 2005 Presidential election, evidence of the use of political marketing techniques could be observed. However, with the onset of the crisis in the Pre-Modern Albanian society, the 2009 political campaign lacked the ability to employ the modern marketing techniques that were necessary. Interviews and campaign materials will be analysed using critical discourse analysis, arriving at the meaning of what we observed, viewing it in the context of Albanian history and culture.

## **KEYWORDS**

Economic Crisis, Albania, Political Marketing Techniques.

## **JEL CLASSIFICATION CODES**

M31, G01, D72

## **1. INTRODUCTION**

Modernization has ushered in significant changes in the technological, political and social systems worldwide. Advanced capitalist countries experience a shift from party-centered to candidate-centered campaigning, the growing power and autonomy of the media and the emergence of catch-all parties, as ideological ties to traditional groups weaken. Economic globalization has redefined our social relationships, our values, and our perceived needs. In our modern society, the global shift of power from production to consumption has displaced traditional political forms, redefining social roles and functions that conform to marketing dictates. Today, we will focus on political campaigning and the use of marketing strategies, in the context of developing societies.

We will examine how Albania, an emergent democracy, which is largely traditional in its political and social expressions, attempts to incorporate innovations in electoral campaigning, under the limitations imposed by the serious financial crisis. Research results will be presented of the 2009 electoral campaign for Parliament. Interviews and campaign materials have been analyzed using critical discourse analysis, arriving at the meaning of what we observed, viewing it in the context of Albanian history and culture.

As an emergent democracy that was under totalitarian rule until 1990, Albania presents an intriguing case. Though other countries in Eastern Europe and the Balkans share Albania's history of a dictatorship, none have experienced such total isolation from the rest of the world as Albania had under its totalitarian government. Today, as it is targeting to sustain its democratic institutions and move toward modernization, Albania faces a serious financial crisis. The 2008-2009 crisis has seriously slowed down growth, which fell from 6 percent to 3.3 percent in 2009. In 2012, Albania's growth was at 2.7 percent. Trade and hotel growth fell to 0.6 percent in the highest quarter. Construction continues to experience a double-digit decline. The fourth quarter of 2012 was very difficult for all sectors of business, which report negative growth rates. Industrial activity continues to decline. The crisis has caused lower exports. Fiscal revenues and growth have seriously declined. As in all the Balkan countries, people in Albania worry about jobs, health services, education and pensions. Given this socio-economic environment, one cannot deny that stages of the political process must also be affected.

The use of campaign strategies taken from advanced democracies, which are at the stage of modernization by a country that has, for the most part, traditional internal systems and is currently in the midst of a financial crisis must draw the interest of researchers who attempt to understand the country's process of change from an isolated totalitarian system to a modern democratic society. Our research hypothesis is one that was approached with great caution. Given the relatively brief time that Albania has been a democracy, it was posited that the campaign under study would certainly reveal that any evidence of modernization would be limited to the particular campaign. No such evidence would be found in the Albanian society at large. Attempts to implement marketing strategies in the political campaign would be compromised by the financial crisis in the country. The Albanian fiscal position deteriorated during 2009 as the global crisis adversely affected the country's economy, as outlined by G. Tremonti of the International Monetary Fund in October, 2009.

Nevertheless, Albania is struggling to modernize. The country's bid for membership to the European Union, is evidence that it is now looking to advanced democracies in the West as models for its continued development and wishes to be part of the western community. The research will show that capitalist democracies in Europe serve as role models for Albania. In fact, the case study of the 2009 electoral campaign was chosen precisely because it included some modern elements of campaigning. The candidate exploited his image as a celebrity. The campaign focused on the candidate, not his party, to a great degree. Marketing techniques for advertising and electronic media strategies were used. However, in view of the financial crisis, it was impossible to reach those voters who did not own electronic media. Furthermore, campaign funds were limited. This campaign, in the context of Albania's traditional society was extremely interesting and could not be ignored. Studies of this kind, however small in scope, contribute to our knowledge of the process of change, and how a country's particular social, political and technological conditions may define its development toward modernization.

Following the collapse of one of the most prolonged (1944-1990) isolationist and totalitarian regimes in Eastern Europe in the early 1990s, Albania inherited a media system with only a handful of state-owned media outlets controlled austere by the communist state, "...which used them as tools of indoctrination" (HRW, 2002). As the country follows a rather troubled and challenging path of transition from totalitarianism and severe isolation to democracy and rule of law, the political system and the society as a whole, and particularly, the media landscape have changed dramatically. The early 1990s saw a striking proliferation of an array of press outlets of a diverse range in breadth and scope, while at the end of the decade, a privately-run radio and television industry appears. Surprisingly, considering the market size and potential of a country with roughly 3.2 million people (INSTAT, 2002), Albania has reportedly some 257 media outlets currently, including television and radio stations (OSI, 2005).

Despite the significant changes in the media landscape in a country newly-introduced to the practices of a pluralistic society and a free market economy, the media industry remains far from being a viable and developed market. The combined daily circulation figure for some 19 nationwide news dailies remains well below 60,000 in total (Source: Albanian Media Institute). As some researchers argue, the highly biased press and high production costs appear to be the cause of a struggling press industry. (HRW, 2002).

## **2. THE 2009 PARLIAMENTARY CAMPAIGN**

In this case study we attempt to answer the questions, “Does Albania’s political campaigning exhibit elements of modernization? Is there evidence of change toward modernization in the country’s traditional institutions? Is there evidence of the implementation of marketing strategies in political campaigns? To what extent does the financial crisis limit the implementation of marketing strategies? ” The research design is based on two methodological approaches: a critical discourse analysis of campaign material, specifically, television political advertisements and interviews of central campaign figures.

Fourteen videos of the television political advertisements were obtained from the archives. These represented the total number of television advertisements used in the Edi Rama 2009 election campaign. For the purpose of this research, four videos were chosen for analysis, based on the following criteria. An attempt was made to isolate those videos which were representative of the television advertisement campaign, avoiding repetition. In addition, videos were chosen for the clarity and power of the campaign message that was communicated. Finally, videos that included elements never before used in Albanian electoral campaigns, such as examples of political marketing techniques, were chosen for analysis.

This research also included four interviews taken from the leader of the Albanian Social Party, Edi Rama, his campaign manager, Vali Bizhga; the President of the Albanian Journalist Union, university professor of journalism, and political analyst, Aleksander Cipa, who has extensive experience in political analysis in Albania. Qualitative, in-depth, semi-structured interviews were used.

## **3. EMERGENT THEMES**

### **3.1 Personalization – branding, candidate presence, monitoring voter reaction**

When discussing the electoral campaign, and the achievements of his previous two terms, Edi Rama used “I” and “my” very frequently and never used “we.” Thus he conveyed the importance of the candidate, himself, on the success of the campaign.

Candidate Edi Rama used the prestige of his office as Party leader to project himself as a capable, successful personality. He mentioned the videos he appeared in, as being the most successful campaign material. He appeared on talk shows and debates.

He had his own radio show where he spoke with the people who called, about their concerns and problems. He thus projected the image that he cared. He received voter input and monitored voter reaction.

### **3.2 Political marketing and celebrity politics in Albania since the 1990s**

Candidate Edi Rama had made a song before the 2009 campaign, with a famous rap group that was very successful. It was remembered in 2009. “The song was successful, it was still remembered...” He is also an artist turned politician. He revealed that this was a “double-edged sword”. He was known and this gave him the advantage, at first, but he was well aware that people may not trust him in the role of a politician, and he knew that he had to “prove” himself. He felt he was successful because his building projects, his accomplishments, were visible to the people.

Furthermore, both Edi Rama and his campaign manager Vali Bizhga made several references to their use of political marketing strategies, designed after the American model and the presence of an American adviser in their campaign team. He openly stated an admiration of the more advanced West and America, in particular, also mentioning Albania’s wish to be a full member of the European Union. Vali Bizhga revealingly states, “Living in a free-market society, we must conform or perish. Obviously, I don’t like to think of voters as consumers, but in today’s world, if we don’t use political marketing strategies, we are left behind. And that’s the reality.” He did add, however, that the financial problems in the country limited their resources and did not allow them to carry out campaign strategies to the extent they felt was necessary.

### **3.3 Ideology**

Responses on political ideology reflected traditional views. Candidate Edi Rama made references to his party, emphasizing its leftist ideology, which attracts a left wing electorate.

Campaign manager Vali Bizhga also referred the role of political ideology and the voters' strong identification with parties because of ideology.

Political analyst, A. Cipa, commented on the presence of strong political party ideologies, stating that the parties were inflexible and unbending, each having their own interests in mind only, even at the expense of Albania's interests.

### **3.4 Language and negative campaigning**

Political analyst, A. Cipa mentions in his interview that the language used by E. Rama to the electorate about his opponent was negative and antagonistic. Even though this negativity of language began with his opponent, E. Rama responded with the same kind of language, and made the same mistake.

Campaign manager, Vali Bizhga, confirmed A. Cipa's comment about language, connecting it to American strategies. She commented, "We had a mixture of positive and negative campaigning, a new strategy for Albania inspired by American politics."

### **3.5 Political favors – corruption**

Edi Rama made reference to the existence of political corruption in Albania, stating this was one element of Albanian society that held the country back, preventing it from moving forward toward the Western model.

Political analyst A. Cipa expressed concerns about the adversarial roles adopted by all parties in Albania. He included E. Rama, giving a picture of a candidate that was not very different from the others. About party corruption, he states, "They will do anything to win. Political parties in Albania will not stop at anything, even 'buy votes.' Corruption in the public sphere is rampant."

### **3.6 Political Parallelism Media Autonomy/Control**

Political analyst A. Cipa provided information on the status of journalists, stating that journalists do not have the education or professional training their counterparts in the West have. In fact, the majority of journalists in Albania do not have a university education and, consequently, they do not enjoy job security. As a result, they are vulnerable and easily controlled by financial and political interests. Political parties still retain total control of all traditional political party functions. In Albania, there is no merging of mass media and the public sphere as is the case in modern market societies in the West. Media are not autonomous, politically or economically and government / political party influence and controls of the print media is often seen. Consequently, media neutrality is not evident.

### **3.7 Personalization – Branding**

Although the element of personalization, in the 2009 electoral campaign appears at first glance to be absent from the campaign advertisements aired on television, Edi Rama's presence was felt very much through the use of his voice, and his logo in three of the four videos analyzed. In fact, one could not ignore the impact of his imposing personality watching the campaign material, even when his presence was symbolic, through the use of his logo. Personalization was indeed central to the campaign as was also substantiated by the interviews conducted. Achievements of his previous terms were referred to as 'his', not 'ours' and when he spoke about the campaign, he used the pronoun 'I' not 'we'. Reference to his party, the Social Party of Albania was only made through the use of E. Rama's title as its leader.

Edi Rama also used his radio show as a political platform to speak with people who called in to discuss their concerns. Here again we have the 'selling' of the candidate who is presented as the person who cares and has the expertise to solve the problems of the electorate. He appears to have the people and their

problems prominent on his list of priorities. In fact, through the radio show, he can monitor public response, gauge campaign progress and gain visibility. There is no information to indicate that Edi Rama acted on concerns expressed by the public. There is no reference to such action in his campaign materials.

### **3.8 Political Marketing Strategies**

Strong evidence of political marketing strategies was found in both the campaign materials and in the interviews. The use of electronic media advertising, to 'sell' the candidate, his program and achievements, attacking his opponent through clever mini scenarios, all were strategies that used the advertising techniques of a free market. In the interviews, the candidate and his campaign manager strongly describe their belief in a marketing approach to campaigning. The campaign material which was cleverly designed for maximum impact, attacked his opponent forcefully, and conveyed the image of E. Rama as the best choice, the indisputable winner.

### **3.9 Political Ideological Ties**

Ideological ties are strong in Albania, as documented by the interviews. Political parties are characterized by their strong political ideology and the electorate behaves according to ideological beliefs at election time. The campaign used in this research did not target voters from other parties, because people just don't switch, they remain loyal to the parties that represent what they believe in. Political ties are described as inflexible and unbending. Political parties and voters in Albania today, still cling to traditional functions and behaviors.

The information obtained through this research in these areas represents perhaps the most important aspect of our research. Whereas campaign findings presented on the phenomena of personalization, celebrity politicians, political marketing strategies and American influence suggest a possible trend toward modernization, however slight, strong ideological ties, political parallelism, State control of the media and the existence of corruption, all clearly suggest that the Albanian reality is very far from modernization. This was a sobering finding, but not an unexpected one. It appears that Albanian society has not yet rid itself of all the social and political characteristics of its political past, before it became a democracy.

To examine this in more detail, we will see it in the context of the information outlined in the "Albanian Context" included in this paper. The media in Albania are struggling to survive as entities because of economic difficulties. Circulation is low, journalists are ill-prepared professionally, the majority having no higher education and no job security, making them vulnerable to editorial or self-censorship. The print media rely on State advertising and subsidies to survive. State control, therefore, is imposed through the withholding of subsidies and the reduction of advertising. The struggle to survive leads to corruption.

This information leads us to reevaluate the importance of the innovations used in the campaign we researched and analyzed. Standing alone, the use of modern elements of political campaign communication techniques appears hopeful and promising, suggesting change in Albanian society is possibly occurring. However, seen in the context of other social, political and economic considerations, such as the financial crisis, state-media relationship, party-press parallelism, corruption and Albania's political history and the very short time it has been a democracy, the innovations we observed lose the value we initially assigned to them. Instead, they appear as isolated events that have no connection to the rest of society.

Returning to our research questions "Does Albania's political campaigning exhibit elements of marketing strategies? Is there evidence of change toward modernization in the country's traditional institutions?" We can now say that our research results suggest Albania's political campaigning does exhibit elements of modernization, but these are not phenomena that are the result of long-term technological, social and political changes in the society at large. Albania may be struggling to modernize, and in its use of modern campaigning techniques it is succeeding, to a very limited extent, because of the presence of an American consultant and the presence of electronic media. However, the media in Albania are not without controls and they do not perform the significant political functions they have come to assume in modern political systems. Though Rama's campaign recruited the services of an American professional campaign advisor and used political communication techniques that are characteristic of modern campaigns, in fact, these are not widely used in Albania's political sphere, nor are they the result of an internal process of modernization. The American consultant used in Rama's campaign was limited to the design of the videos used to advertise the candidate, in contrast to modern campaigns where an array of professional consultants share in all the

political decisions and assume greater power in the political sphere than was the case in the campaign under study.

Traditional elements of campaigning and political communication were still relied upon in Rama's campaign. The candidate himself, relied on the direct personal contact with the electorate, through his radio programme; a partisan press still exists, strong party loyalty and traditional political communication techniques still characterize the political process in Albania today. As researchers have observed, political campaigning techniques borrowed from more advanced countries, predominantly the U.S., merely exist in traditional societies, they do not change them.

Election campaigns in Albania are still carried out at the local level and basic prerequisite conditions in Albanian society do not exist to support the thesis that we are witnessing a process of modernization in the country. These prerequisites include the existence of a viable market economy, an economically healthy mass media system that is autonomous, assuming functions traditionally assigned to the political sphere, and the development of advanced technology. Therefore, at present Albania is very much a traditional society that is attempting to adopt some innovations from the U.S., but these have not developed from, and are not supported by, the existing systems within the country. The country still retains its strong ties to political ideology and parties, the media are not autonomous in a competitive, commercialized environment, which empower them in the political sphere, and lead society toward modernization. Society as a whole has not reached the level of complexity and differentiation found in technologically more advanced countries. The existence of the innovations we witnessed in Rama's campaign, therefore, do not signal a change in Albanian society toward modernization.

To conclude, Albania appears to be at the pre-modern stage of social and political development, as it is defined by researchers and analysts. Nevertheless, given the globalized world it exists in, with the speed at which information, ideas and practices are transferred from one country to another, it is only a matter of time before the country experiences modernization. However, the current financial crisis does present an obstacle to its evolution toward more advanced technological, social and political institutions. One can only conclude that Albania will eventually join the modern western community. Its bid for membership to the European Union is a significant step toward this goal.

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# **EXCHANGE RATE REGIMES IN THE NEW EU MEMBER STATES AS FACTORS FOR BALANCE OF PAYMENTS SUSTAINABILITY. THE CASE OF BULGARIA**

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## **ABSTRACT**

The choice of exchange rate regime is one of the major questions faced by the transition economies from Central and Eastern Europe (CEE). As the role of the exchange rate regime for the economic development and external competitiveness of a country is very important, the discussions on fixed versus flexible currency are inevitable. These debates could be further developed through assessment of the nature of the catching-up process in terms of trade and investments dynamics in and out of the CEE countries. The balance-of-payments statistics provide enough information for analysis of the external positions of an economy, but they also give clues on the sustainability of a country's economic development and the impact of a flexible/fixed exchange rate on its competitiveness. In the last decades it became generally accepted that the transition and catching-up process in the CEE countries results in balance-of-payments imbalances proven by the statistical data. That circumstance raises the issue of the sustainability of these imbalances and the methods for assessment of their long-term impact on the economy. Thus, the purpose of this paper is to analyze the dynamics of the main balance-of-payments accounts in the new EU member states from Central and Eastern Europe – Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia, in order to outline the dependency of these dynamics on the exchange rate regimes in the selected countries. The focus is on the balance-of-payments dynamics between 2004 and 2012 and the key country of analysis is Bulgaria as it was found that the external imbalances in this state are the most distinct in the years before the crisis in comparison to the rest of the selection. Additionally, in the period of 2009 – 2012 a balance-of-payments adjustment is registered in all of the selected countries, including Bulgaria - a circumstance that could provide us with clear and unarguable information on the character of the pre-crisis imbalances and the reasons for the differences in the external positions of the observed countries. An in-depth study of the major factors affecting the imbalances is made in order to define the key processes taking course in the economies and to assess the impact of exchange rate arrangements on them. As a result of the analysis, it is concluded that the currency board system in Bulgaria has a role in stimulating domestic demand which results in further deepening of the pre-crisis balance-of-payments imbalances and worsening of the Bulgarian external positions. These observations are proven, among other factors, by the character of the foreign direct investments in the country, the dynamics of GDP's components and the statistics on foreign indebtedness of the economy. In addition, it is found that the adjustment that takes course after 2009 has much larger negative effect on economic stability in the fixed exchange rate economies in comparison to the countries with flexible currency.

## **KEYWORDS**

Balance of payments; sustainability; exchange rates; currency board; competitiveness; adjustment

## **JEL CLASSIFICATION CODES**

E21, F32, F43

## 1. INTRODUCTION

By choosing exchange rate regime, the new EU member states in Central and Eastern Europe (CEE) aim to resolve several key issues related to the macroeconomic stability in volatile capital environment, the Balassa-Samuelson effect and the fulfillment of the Maastricht criteria. It is clear that none of the exchange rate regimes could ensure accumulative resolution of these problems. For example, the fixed exchange rate could satisfy the stability issue, but could result in huge real exchange rate appreciation which endangers the fulfillment of the Maastricht criteria on inflation. On the other hand, floating regime could provide opportunity for depreciation of the currency rate. Some argue that flexible exchange rates are also tool to cope with asymmetric shocks (*Meade (1951), Friedman (1953)*).

In addition, the most widely used measures of the international competitiveness of a country are PPI- and CPI-based exchange rates. Therefore, when major external imbalance occurs, most of the discussion concentrates on the appropriateness of the exchange-rate parity of the domestic currency (*Vuicic, 1999*).

The currency board arrangement in Bulgaria operates for already 16 years which poses the question on its long-term effect on external competitiveness and stability of Bulgarian economy. Thus, the purpose of this paper is to analyze the dynamics of balance-of-payments accounts, to compare them with the processes characterizing the other countries from CEE and to outline the impact of exchange arrangements on external trade and capital movement in and out of the economies.

For the purposes of this paper, the IMF classification of exchange rate arrangements is used, sample period 2000-2011. According to IMF data, the countries with fixed exchange rate regimes for the most of the period are Bulgaria, Estonia and Lithuania. The member states with pegged exchange regime are Latvia, Hungary and Slovakia, while the countries with floating regime are the Czech Republic, Poland, Romania and Slovenia; the Czech Republic and Poland being the states with the most consistent and durable floating regimes.

## 2. BALANCE OF PAYMENTS SUSTAINABILITY

In the last decades it became generally accepted that the transition and catching-up process in the CEE countries results in balance-of-payments imbalances. The interest in analyzing the balance-of-payments imbalance is due to the direct relation between the current account dynamics and the probability for a crisis in the economy. If the external debt reflected in current account deficits at some point becomes unmanageable, this could lead to collapse in the economy and painful adjustment process. On the other hand, not all countries having current account deficits should face painful rebalancing as long as these deficits are due to inflow of investment capital. Making the distinction between the beneficial and harmful effect of these imbalances on the economic development poses the question of their sustainability and it is being impacted by a number factors, subject to various studies.

### 2.1 Factors for current account sustainability

The current account deficit may be due to a reduction in domestic savings or increase in national investment. The decline in national savings can be attributed to the decline in private or public savings. The latter happens at the cost of budget deficits and accumulating debt. Therefore, this option is considered more unsustainable than the fall in private savings, which is considered a temporary phenomenon, as it is driven by expectations of a strong growth in GDP.

*Roubini and Wachtel (1999)* focus their attention on the intertemporal budget constraint of a country and emphasize that the country's solvency is of particular importance for assessing the sustainability of the registered external imbalances as the ability of the economy to repay its debts is a major criterion for economic stability and clear signal for the nature of foreign currency flows into the economy. Therefore, a non-increasing foreign debt to GDP ratio is seen as a practical sufficient condition for sustainability of external imbalances.

According to *Isard (2001)*, the main parameters that affect the amount of national savings and investment and can be used to explain the movements on the current account are:

- Fiscal balance;

- Demographic structure;
- Net foreign assets;
- Energy market;
- Relative income per capita;
- Economic growth;
- Foreign direct investment (FDI).

On the basis of the above indicators, it can be concluded that the current account deficit can be sustainable as long as the debt is directed towards investment activity rather than consumption. However, investment in export-oriented sectors results in more sustainable current account imbalances compared to investment in sectors serving domestic consumption.

Another approach which is based on the concept of the current account as the difference between savings and investments is the *intertemporal approach*. According to this approach, the level of savings appears to be constant over time - changes in public savings lead to opposite change in private savings. The current account is seen as a buffer that neutralizes temporary shocks to income and smoothes the consumption in the long term. Major contribution of this approach is the attempt to determine sustainable levels of current account deficit on the basis of certain economic indicators.

In a study of the ECB (*Ca' Zorzi et al, 2009*) the intertemporal approach is applied in calculating sustainable medium-term benchmark of current accounts for the countries from CEE on the basis of 13 indicators.

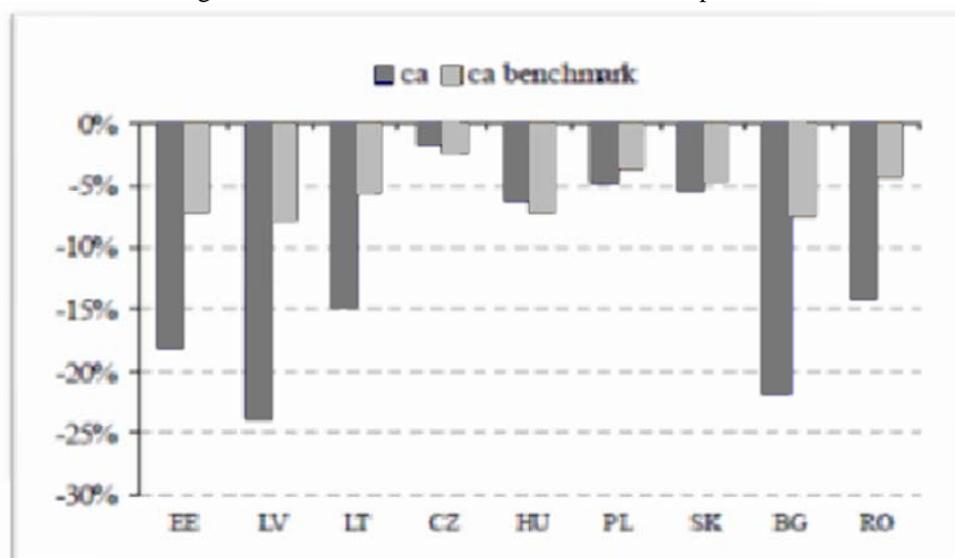
The effect of changes in indicators for Bulgaria's current account is as follows:

Table 1: Relation economic indicators – current account, Bulgaria

Indicators	Period	
	1997/2006	2004/2006
<b>NFA</b>	-1,20	-1,37
<b>Oil</b>	-0,67	-0,66
<b>FDI</b>	0,01	-0,08
<b>GDP</b>	0,30	0,55
<b>Fiscal balance</b>	0,12	0,16
<b>Relative income</b>	-1,64	-1,45
<b>Population</b>	0,54	0,53
<b>Civil liberties</b>	0,20	0,19
<b>Openness</b>	0,27	0,29
<b>Financial integration</b>	-0,02	-0,02
<b>Old population</b>	-0,05	-0,03
<b>Young population</b>	0,10	0,12
<b>Relative income sq.</b>	0,35	0,27
<b>Overall effect</b>	-1,69	-1,51

Figure 1 below shows the results of the econometric calculation for current account benchmarks compared to the actual current account balances in the countries from CEE for 2007.

Figure 1: Current account benchmarks and 2007 position



The distinction between the fixed-rate countries and the flexible-currency member states in terms of compliance of the current-account statistics with the reference values of sustainability is clearly demonstrated. The Czech Republic, Hungary, Poland and Slovakia register sustainable current account imbalances, while Bulgaria, Latvia, Lithuania and Estonia are all characterized by significant deviations from the sustainable mid-term levels.

Zanghieri (2004) attempts to calculate future sustainable levels of current accounts of the new member states. For this purpose, the author examines three contrasting cases: 1) outflow of FDI, 2) stabilization of FDI to the high levels of 2004-2007; 3) FDI and EU funding fixed at 4% of GDP. The results of the study are presented in Table 2:

Table 2: Sustainable level of current account as % of GDP

	No FDI	Stable FDI	High FDI	Average
<b>Bulgaria</b>	-5,7	-9,7	-11,3	-5,5
<b>Czech Republic</b>	-1,9	-5,9	-15,6	-5,5
<b>Estonia</b>	-2,4	-6,4	-11,4	-8,0
<b>Hungary</b>	-2,9	-6,9	-8,2	-3,0
<b>Latvia</b>	-5,0	-9,0	-11,4	-5,1
<b>Lithuania</b>	-2,5	-6,5	-8,5	-8,1
<b>Poland</b>	-4,3	-8,3	-10,7	-4,3
<b>Romania</b>	-2,4	-6,4	-6,4	-4,3
<b>Slovakia</b>	-2,9	-6,9	-18,6	-7,0
<b>Slovenia</b>	-2,7	-6,7	-8,8	-0,4

The comparison between the proposed benchmarks by Zanghieri and the actual dynamics on the current accounts of the selected countries in the pre-crisis years confirms the observation of different path for the countries depending on their currency exchange regime. For instance, the current account deficit for 2007 in Bulgaria reaches 25,2% of GDP, far above the reference 11,3% calculated in the study.

Considering the main conclusions of the presented studies, the next section focuses on the specific data available for the focus countries on key fundamentals such real exchange rate, savings and investment, GDP and FDI. The analysis aims at defining the role of exchange rate regimes for the observed dynamics of the indicators and to draw specific conclusions on their impact on current account dynamics with focus on Bulgaria.

### 3. INDICATORS FOR SUSTAINABILITY OF THE CURRENT ACCOUNT OF BULGARIA. COMPARISON WITH THE SELECTED CEE COUNTRIES

#### 3.1. Composition of the current and financial accounts

- Current account

Table 3 represents the statistical data on the current-account balance as % of GDP for the countries from CEE.

Table 3: Current account as % of GDP, 3-year average, Source: Eurostat.

	2004	2005	2006	2007	2008	2009	2010	2011
<b>Bulgaria</b>	-4.7	-7.8	-11.9	-18.1	-22	-19.1	-11.2	-3.4
<b>Czech Republic</b>	-5.4	-4	-2.7	-2.4	-2.8	-2.9	-2.8	-3
<b>Estonia</b>	-11.1	-10.9	-12.2	-13.8	-13.5	-7.2	-0.9	2.8
<b>Latvia</b>	-9.3	-11.2	-16	-19.2	-19.4	-9	-0.5	3.1
<b>Lithuania</b>	-6.5	-7.1	-8.4	-10.7	-12.7	-7.9	-3	0
<b>Hungary</b>	-7.8	-7.8	-7.6	-7.3	-7.3	-4.9	-2.2	0.6
<b>Poland</b>	-3.5	-3.4	-3.8	-4.1	-5.5	-5.5	-5.2	-4.6
<b>Romania</b>	-5.9	-7.6	-9.1	-10.8	-11.8	-9.7	-6.7	-4.4
<b>Slovenia</b>	-0.8	-1.7	-2.3	-3	-4.5	-3.9	-2.5	-0.4
<b>Slovakia</b>	-7.2	-7.4	-8.1	-7.2	-6.4	-4.7	-4.2	-2.8

Misbalances in Bulgaria's current account are the deepest in comparison to the other countries. Additionally, the comparison between the countries with fixed exchange rate and the countries with flexible regime shows deepening deficits in the fixed-exchange economies (highest deficits registered in Bulgaria, Latvia, Estonia and Lithuania), while the Czech Republic, Slovenia and Poland have deficits between 5 and 10% of GDP during the growth period 2004-2008. After 2009, all monitored countries face current account adjustment. These processes are very intensive in the economies with fixed regime; some of them even report surpluses in 2010 and 2011.

The composition of the current account is approximately equal to the sum of the trade balance and the net factor income. According to *Roubini and Wachtel (1999)*, a current-account imbalance may be less sustainable if it is derived from a large trade deficit rather than a large negative net factor income.

A more in-depth look at the balance-of-trade dynamics in the focus countries demonstrates the "leadership" of Bulgaria in balance-of-trade deficits compared to the rest of the selection. However, the trends of the balance of trade in the rest of fixed-rate economies (Estonia registers positive balance of trade-GDP ratio) requires a closer analysis of the GDP trends in these countries in order to be outlined the similarities and differences between Bulgaria and the rest of the selected fixed-rate countries. According to the Eurostat data, the growth rate of GDP in Bulgaria in the period 2004 to 2008, similarly to that of Estonia, Latvia, Lithuania, Slovakia is several times higher than the EU average. Analysis of the components of GDP for these countries shows an increasing share of final consumption expenditure and a negative contribution of net exports (with exception of Estonia). Net exports of Bulgaria is negative for the whole period 2004 to 2011, while final consumption increased several times and became the main source of growth (table 5).

The intensiveness of the movements on the current account in the economies with fixed currency requires more in depth observation on the main factors for deficit. Figure 2 shows the composition of the Bulgarian current account in the period 2004-2011.

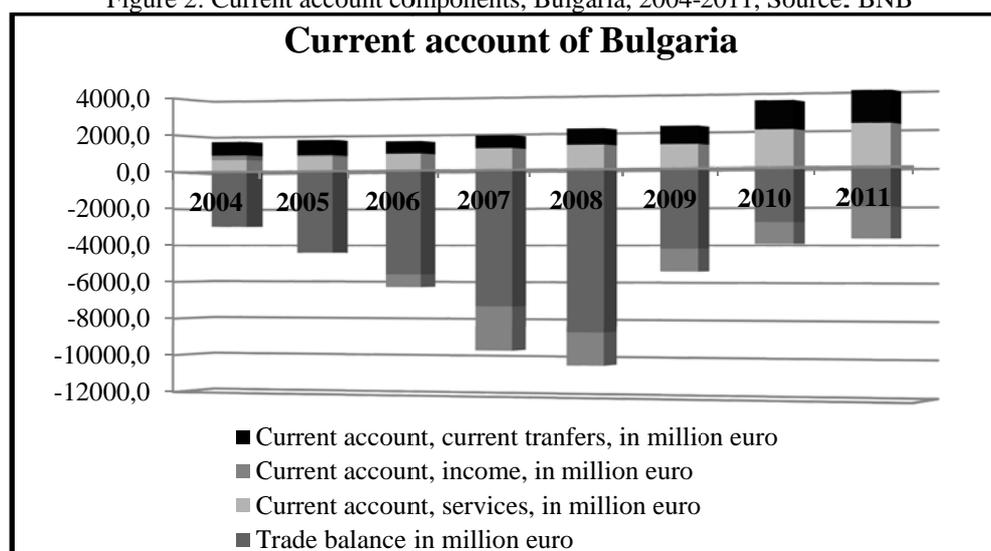
Table 4: Trade balance as % of GDP, Source: Eurostat.

	2004	2005	2006	2007	2008	2009	2010	2011
<b>Bulgaria</b>	-8.4	-11.4	-14.4	-10.6	-11.7	-6.2	-4.1	-3.7
<b>Czech Republic</b>	-4.8	-7.1	-7.6	-7.6	-9.2	-7.9	-10.1	-10.3
<b>Estonia</b>	-4.4	-3.2	2.0	1.9	3.1	4.3	7.1	9.9
<b>Latvia</b>	-5.3	-4.6	-5.5	-5.4	-3.3	-0.5	0.0	-0.6
<b>Lithuania</b>	-5.3	-7.4	-5.6	-2.9	-6.7	-3.2	-4.0	-4.9
<b>Hungary</b>	-9.2	-7.1	-6.3	-6.6	-7.4	-5.8	-6.0	-5.0
<b>Poland</b>	-1.7	-1.3	-2.6	-3.0	-3.4	-2.6	-3.4	-3.6
<b>Romania</b>	-5.3	-5.5	-6.2	-4.3	-4.3	-1.9	-1.4	-0.8
<b>Slovenia</b>	6.3	5.6	5.2	3.7	3.2	3.8	2.4	2.7
<b>Slovakia</b>	-8.5	-10.9	-15.2	-9.1	-9.1	-5.9	-8.1	-8.6

Table 5: GDP of Bulgaria, at prices of previous year, 2000-2011, Source: National Statistical Institute

Year	Final consumption	Gross capital formation	Net export
<b>2004</b>	34,091	8,697	-4,559
<b>2005</b>	37,220	11,408	-6,272
<b>2006</b>	42,812	15,214	-9,580
<b>2007</b>	47,421	18,800	-11,098
<b>2008</b>	52,848	23,856	-12,793
<b>2009</b>	53,271	19,529	-7,299
<b>2010</b>	54,553	16,218	-2,182
<b>2011</b>	55,524	15,880	284

Figure 2: Current account components, Bulgaria, 2004-2011, Source: BNB



The analysis of the current account shows that the dynamics are due to trade balance and factor income. The biggest changes are reported in trade of goods with constantly increasing negative balance till 2008. This means a significant excess of imports over exports, which is a signal of growth of domestic demand for imported goods or drastic reduction of Bulgarian exports. While in 2003 import represents only 50% of GDP, in 2008 it is already 70% of GDP. At the same time, in exports the changes are much more gradual – 35% of GDP in 2003 compared to 45% in 2008.

In the period 2009-2012 the current account is positive for the first time in the last decade, again due to the significant changes in the balance of trade. We observe a 33% decrease in imports in 2009; exports are reduced by 23%. Consequently, the import and export composition could provide more valuable information on processes characterizing the Bulgarian economy.

Table 6 presents the classification of imported goods. The highest average annual growth rate is observed in energy resources (21.58%), due to the global increase in oil prices - while in 2003 price is around \$34/barrel, in 2008 it reaches \$95/barrel. A worrying trend of import data is that consumer products, albeit with the smallest share in real terms (excluding "other imports"), increase faster than investment goods and raw materials. The average annual increase in imports of consumer goods is approximately 10%.

Table 6: Import structure, in million euro, 2004-2012, Source: BNB

<b>Imported goods/ Period</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>Average annual growth (%)</b>
<b>Consumer goods</b>	1894.7	2258.7	2736.6	3585.7	4330.9	3494.1	3845.4	4229.6	4400.2	<b>9.81</b>
<b>Raw materials</b>	4602	5279.5	6748.8	7904.1	8414.3	5771.4	6866.6	8774.4	8775.8	<b>7.44</b>
<b>Investment goods</b>	3085.1	4033.5	4845.4	6068.7	6871.1	4206.3	4201.7	4980.0	5834.9	<b>7.34</b>
<b>Energy resources</b>	1941.8	2962.6	4041.3	4302.6	5458.6	3365.2	4273.7	5365.9	6420.9	<b>14.21</b>
<b>Other</b>	96	133.5	107.3	0	19.3	38.4	57.4	56.2	52.3	<b>-6.52</b>
<b>TOTAL /CIF/</b>	<b>11619.5</b>	<b>14667.7</b>	<b>18479.3</b>	<b>21861.2</b>	<b>25094.2</b>	<b>16875.4</b>	<b>19244.8</b>	<b>23406.2</b>	<b>25484.0</b>	

Export structure (Table 7) retains large share of consumer goods and raw materials to total exports. However, investment goods are making significant average annual growth, although in real terms they are far below the levels of exports of consumer goods and raw materials. Dynamics in the export of energy resources can be attributed to the higher international prices for this type of resources. In short, although there are some trends for restructuring of Bulgarian exports, these changes are very slow and the overall profile of Bulgarian exports continue to be focused on goods with low added value of low-tech industries.

As revealed by the statistics, the current account imbalances are due to the increasing trade inflows, whose growth rate exceeds several times the exports registered during the period. From this perspective, the trends indicate unsustainable deficit levels. This conclusion is due to the following already analyzed circumstances: 1) Growth of imports faster than export growth, 2) increasing share of imports as % of GDP, 3) low value-added exports; 4) Growth driven by strong domestic consumption.

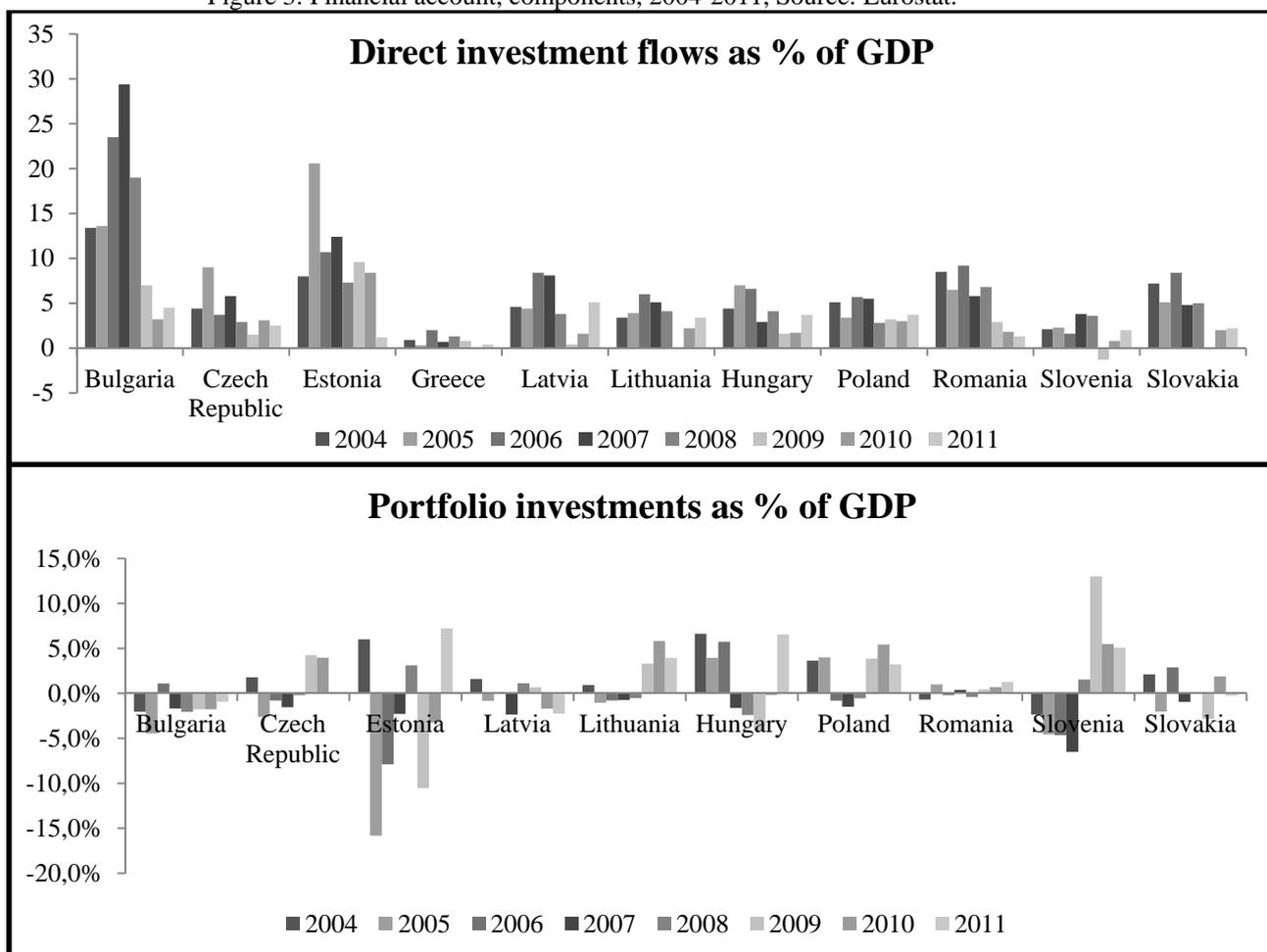
Table 7: Export structure, in million euro, 2004-2012, Source: BNB

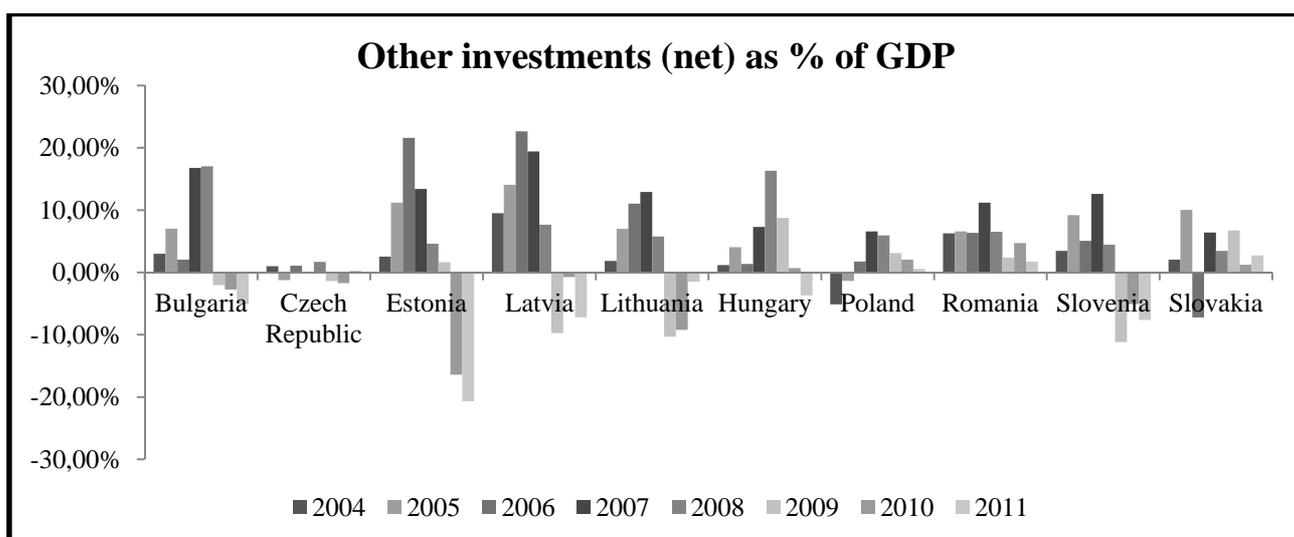
Imported goods/ Period	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average annual growth (%)
Consumer goods	2623.4	2728.6	2948	3250	3417.7	3289.6	3950.8	4505.9	4817.4	6.99
Raw materials	3477.6	4056.2	5465.7	6105.3	6765.2	4993.2	6824.3	9403.1	8962.5	11.09
Investment goods	1075.3	1459.7	1738.8	2160.8	2516	1898.3	2666.9	3532.5	3523.5	14.1
Energy resources	808.6	1221.8	1859.3	1995.8	2500.9	1513.2	2113.6	2814.9	3481.4	17.61
Other	0	0	0	0	4.1	4.8	5.5	7.9	8.3	-
<b>TOTAL</b>	<b>7984.</b>	<b>9466.</b>	<b>1201</b>	<b>1351</b>	<b>1520</b>	<b>1169</b>	<b>1556</b>	<b>2026</b>	<b>2079</b>	
<b>/FOB/</b>	<b>9</b>	<b>3</b>	<b>1.9</b>	<b>1.9</b>	<b>4</b>	<b>9.2</b>	<b>1.2</b>	<b>4.3</b>	<b>3.1</b>	

- Financial account

Figure 3 represent data for the three main components of the financial account – direct investment, portfolio investments and other investments.

Figure 3: Financial account, components, 2004-2011, Source: Eurostat.





Bulgaria is characterized by the largest inflows of direct investments as % of GDP, together with Estonia. However, it ought to be noted that the growth of net investments is slower than the accumulation of current account deficits in Bulgaria. While in 2004 net direct investment-current account ratio is 172%, in 2008 the flow of direct investment can cover only 76% of the current account deficit. Similar situation in 2009 results in reduction of the Bulgarian national bank official reserves.

Another trend that deserves attention is the dynamics of other investments in the countries with fixed exchange rate. In the pre-crisis period they have significant positive values, while since 2009 it is noted a drastic outflow of investments in these countries. The positive balance of that account in 2004-2008 marks the increase of external financing of private sector and/or accumulation of non-residents' deposits in national banks. The fact that these processes happen in a fixed-exchange rate environment provides an explanation of the differences between investments inflows into fixed-rate and flexible-currency countries. The fixed exchange rate in these countries results in serious appreciation of the national currencies and fall of real interest rates – a circumstance stimulating lending in the countries. However, the crisis leads to outflow of foreign capitals and dramatic contraction of domestic demand.

The main conclusions of the analysis of the balance-of-payments imbalances in Bulgaria can be summarized in three points: 1) Large current account deficits due to the balance of trade, 2) Large surplus on the financial account due to direct investments and other investments, and 3) a strong effect of external economic shocks on domestic stability.

### 3.1. Foreign debt to GDP

Increased capital inflows suggest confidence in the banking system at least to the level of accumulation of foreign deposits in banks in the country. On the other hand, excessive accumulation of foreign savings in banks means that the banking sector increasingly relies on outside funds to finance its operations. This poses a risk for a crisis in the banking sector. This danger becomes even more serious when the ratio of loans and deposits is deteriorating due to credit growth.

This is exactly the situation in the CEE countries after 2000. In most countries of the region, with the exception of the Czech Republic and Poland (*Gardó et al.*, 2010), this leads to increase in foreign claims compared to liabilities. It should be noted the increasing trend of foreign currency loans (again with the exception of the Czech Republic), which enhances the external financial dependence of countries and contributes to increasing imbalances in countries with fixed exchange rate, as it has an impact on the level of the real exchange rate (appreciation of the real exchange rate, leading to an overestimation of the nominal exchange rate).

The described processes make the sector and the economy vulnerable due to the increasing dependence on external resources. This vulnerability can be seen clearly in 2008-2011, when foreign savings inflows stop resulting in freezing of the banking sector. This is especially true for countries with fixed exchange rate,

where the inflow of direct investments is not sufficient to cover the widening current account deficit, i.e. external debt grows and, what is more, it is a short-term indebtedness. The ratio of short-term debt of these countries to the level of official reserves (which should serve as a buffer) deteriorates (*Gardó et al., 2010*).

Figure 4: Private debt, Official reserves and Public debt as % of GDP, Bulgaria, 2003-2011, Source: BNB

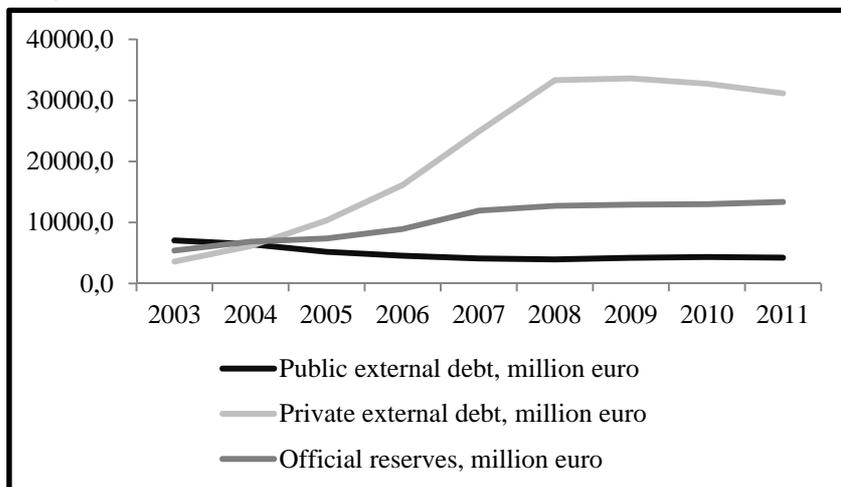
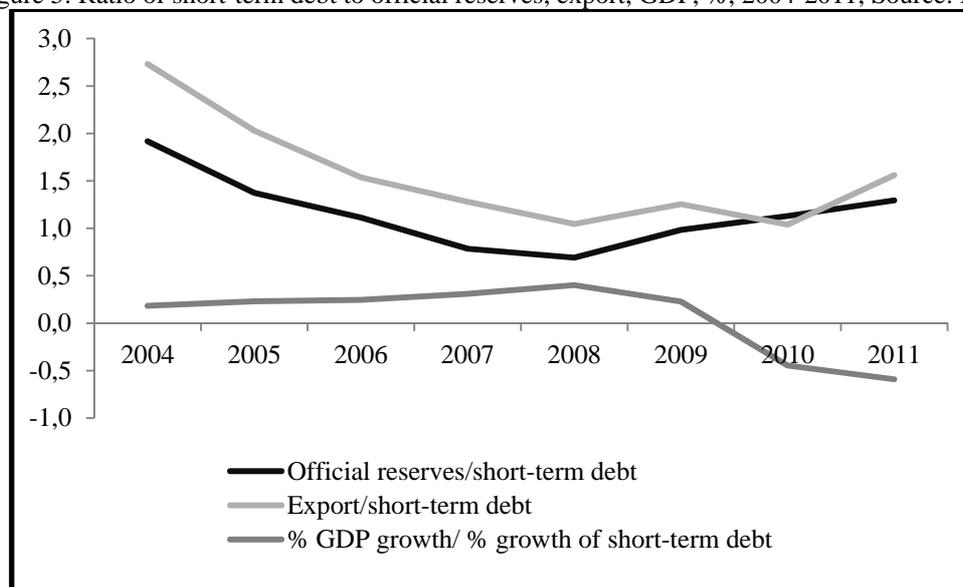


Figure 4 illustrates the growth rate of private and public external debt and official reserves in Bulgaria. In 2011 the rate of increase in private foreign debt is several times greater than that of the reserves, although official reserves start at higher levels.

Figure 5 presents a more detailed picture of the indebtedness of the Bulgarian economy by tracking dependencies between the main tools for reducing debt and short-term debt.

Figure 5: Ratio of short-term debt to official reserves, export, GDP, %, 2004-2011, Source: BNB



Foreign exchange reserves and export earnings start at around 2 times higher values than those of short-term debt, but the pace of their growth outpaces growth in exports, as well as official reserves. GDP grows several times slower than short-term debt. This is a symptom of a serious loss of competitiveness of the Bulgarian economy and indicates enormous risks of destabilization in case of outflow of foreign capital from the country. This outflow occurred in 2009 and 2010. As a result of the global crisis, foreign investors abruptly retreat, the banking sector reduces lending, i.e. funding sources of growth almost disappear. These processes lead to a drastic reduction in market liquidity, reducing consumption, which is a major driver of

growth in the previous years. The effect is further enhanced by the lack of instruments for reaction of the state, because of the currency board arrangement. This process is observed in all other countries with fixed exchange rates in the region, which also recorded highest growth in the period 2002 to 2008. The decline in GDP for 2009 is highest in Lithuania (-14.8%), Latvia (-17.7%) and Estonia (-14.3%). The only country that is not in recession in 2009 is Poland which skillfully uses the tools of monetary and fiscal policy to counteract this effect.

### 3.2. Real exchange rate

Large discrepancies between the nominal and real exchange rate can cause significant deterioration in the international positions of a country. That problem is particularly acute for countries with fixed exchange rate as Bulgaria, where the real exchange rate moves away from the nominal rate over time as a result of different rates of growth and price levels in the economy with a fixed exchange rate and the state-anchor, which affects the competitiveness of exports. If a parallel on exports to the EU is made between CEE countries with fixed exchange rate and floating rate, the following trends are observed - Slovakia and Romania increased their share in EU imports from 2000 -2010 about 3 times, while Bulgaria, Latvia and Lithuania increased their market positions about 2 times. Tables 8 and 9 represent the changes in real and nominal effective exchange rate of the CEE countries. Logically, the differences between the two rates in countries with fixed exchange rates are much higher than those of countries with floating rate. For Bulgaria the ratio of the real effective exchange rate is 124.90 (for 2011), diverging significantly from the ratio of the nominal exchange rate: 102.48. A slight movement of the nominal exchange rate, at the expense of increase in the real exchange rate is also typical for Latvia and Estonia.

Table 8: Real effective rate, CPI, 2005=100, Source: Eurostat

	2004	2005	2006	2007	2008	2009	2010	2011
<b>Bulgaria</b>	97.29	100.00	104.75	109.64	119.61	124.54	124.49	124.90
<b>Czech Republic</b>	94.61	100.00	104.81	107.00	123.11	119.00	122.57	125.27
<b>Estonia</b>	97.80	100.00	102.12	105.99	113.29	115.28	114.64	116.26
<b>Latvia</b>	100.24	100.00	103.98	110.57	122.81	128.44	122.24	123.80
<b>Lithuania</b>	99.96	100.00	101.11	103.73	110.94	117.87	115.65	116.82
<b>Hungary</b>	98.03	100.00	95.24	104.99	108.10	102.77	106.50	106.07
<b>Poland</b>	89.01	100.00	102.20	105.08	115.04	98.17	106.32	104.06
<b>Romania</b>	83.93	100.00	107.12	115.62	109.80	101.87	106.01	108.36
<b>Slovenia</b>	100.58	100.00	100.18	101.09	103.36	105.95	105.27	104.42
<b>Slovakia</b>	96.96	100.00	105.50	114.94	124.70	133.75	130.26	131.70

Table 9: Nominal effective rate, 2005=100, Source: Eurostat

	2004	2005	2006	2007	2008	2009	2010	2011
<b>Bulgaria</b>	100.73	100.00	99.82	99.44	100.50	103.25	102.42	102.48
<b>Czech Republic</b>	94.10	100.00	104.88	106.47	119.30	115.75	119.82	123.45
<b>Estonia</b>	99.88	100.00	99.90	99.71	100.84	103.87	102.08	101.38
<b>Latvia</b>	105.06	100.00	99.72	98.93	99.74	102.37	100.42	100.59
<b>Lithuania</b>	100.26	100.00	99.74	99.46	100.23	103.46	101.93	101.91
<b>Hungary</b>	99.28	100.00	93.56	97.80	98.43	90.83	91.53	90.36
<b>Poland</b>	89.07	100.00	103.14	105.84	115.32	95.43	102.41	99.25
<b>Romania</b>	89.60	100.00	102.75	108.24	98.71	87.47	87.35	86.80
<b>Slovenia</b>	100.88	100.00	99.79	99.35	99.75	102.34	101.35	101.37
<b>Slovakia</b>	97.60	100.00	103.33	113.22	122.57	131.59	129.64	129.63

The reaction of real exchange rates of the two groups of countries at the time of crisis is worth noting. While the real exchange rates of all countries with floating exchange rates indicate depreciation of their currencies, which mitigates the negative effects of the worsening international economic conditions, in all countries with fixed exchange rate it is observed just the opposite trend - continued real appreciation of the currencies. In that situation these countries are faced with the choice to reverse the process through currency devaluation (a step that is usually accompanied by disruption and loss of confidence on international markets) or to provoke deflation in order to depreciate the currency.

Latvia, Lithuania and, to a lesser extent, Estonia initiate the so-called "internal devaluation" - a process of reduction of wages in the public and private sectors and cutting of public spending. These measures in Latvia reinforced by the policy of budget deficits in the years of growth, led to the highest recession recorded in the EU in 2009: -17.7%.

### 3.3. National savings and investments

The examination of net savings in Bulgaria for 1998 - 2008 shows that a yearly fluctuations occur, the general trend is their size to reduce (Figure 6).

Figure 6: Net savings, million euro, 1998-2008, Source: Eurostat

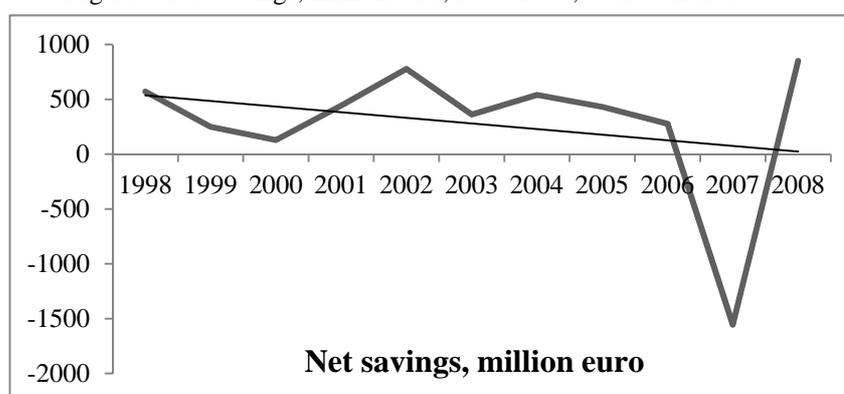


Table 10 presents the expenditures on fixed assets in Bulgaria in different economic sectors for the period 2000 to 2007. Although this indicator does not represent the total volume of investments made, it still gives benchmark for investment activity by sectors. From the data shown, it can be concluded that the actual volume is dominated by investment in manufacturing. However, the highest growth rate of investment in fixed assets is observed in the sectors: real estate and business services, construction, social and personal service, i.e. non-tradable sectors, serving domestic consumption.

Table: 10: Investments in fixed assets, 2000-2007, Source: NSI

Economic sectors	Asset expenditures, thousand leva, 2000-2007	Annual average growth, 2000-2007
<b>Manufacturing</b>	19974639	17.7
<b>Transport</b>	15174919	12.4
<b>Retail trade</b>	13869694	21.8
<b>Real estate and business services</b>	11558691	48.4
<b>Construction</b>	8919678	34.3
<b>Electricity, water and gas production</b>	8902293	18.9
<b>Hotels and restaurants</b>	4685898	18.4

(cont.)

<b>Social and personal services</b>	2691222	33.1
<b>Agriculture and forestry</b>	2639988	24.5
<b>State administration</b>	2140341	11.9
<b>Financial intermediation</b>	1985499	23.3
<b>Extractive industry</b>	1729492	19.2
<b>Health and social activities</b>	1138371	19.2
<b>Education</b>	803137	29.8
<b>Fishery</b>	14952	-

### 3.4. Foreign direct investments

Although from 2000 to 2008 CEE countries attract significant capital in the form of foreign direct investment, it is not a sufficient condition for sustainable growth of these economies. Real assessment of the growth potential of these countries through FDI depends on the sectors of interest. About one third of investments in CEE countries are concentrated in the financial sector, the service sector and the retail sector (*Rahman, 2008*). However, with the exception of Lithuania, investments in processing industry are relatively small. To some extent, intensive investment in the services sector is due to the low initial level of development of the sector, but on the other hand, excessive investment in non-tradable sectors stimulate domestic consumption. Described phenomena fully apply to Bulgaria. Table 11 presents the distribution of FDI by sector. Although the amount of investment in the manufacturing industry is the largest in the period 1999-2010, followed by the investments in real estate and business services, financial intermediation and trade; their total amount significantly exceeds the investment in the manufacturing sector. These sectors also report the highest average annual growth rate of investment, which is an indication of increased foreign investor interest in these sectors. The majority of these investments have no effect on production capacity and exports. This structure of investment is also the reason for the sharp outflow of foreign direct investment in 2009.

Table 11: FDI, million euro, 1999-2010, Source: BNB

<b>Sectors</b>	<b>Total, 1999-2010</b>	<b>Average annual growth rate</b>
<b>Government sector</b>	1.0	5.95
<b>Education</b>	14.2	26.32
<b>Fishery</b>	25.0	14.35
<b>Health and social activities</b>	60.6	22.44
<b>Non-classified</b>	750.9	13.88
<b>Agriculture and forestry</b>	863.2	33.64
<b>Social and personal services</b>	1105.0	30.50
<b>Extractive industry</b>	1326.8	20.18
<b>Hotels and restaurants</b>	2945.4	27.81
<b>Production of electricity, water and gas</b>	8326.9	22.90
<b>Construction</b>	11367.3	41.70
<b>Transport</b>	24056.8	25.29
<b>Retail trade</b>	26206.2	29.70
<b>Financial intermediation</b>	31576.5	32.87
<b>Real estates and business services</b>	35236.7	44.21
<b>Manufacturing</b>	38308.9	16.03
<b>TOTAL</b>	182170.8	26.40

The development of the country in the period 1998 to 2011 shows that the positive long-term impact of foreign direct investment is not achieved automatically. It depends on the qualitative structure of the investments and the economy's ability to absorb them.

Some researchers (*Bems et al., 2007*) consider intensive investment in non-tradable sectors in the CEE countries as a first phase of a two-step process of convergence. If this reasoning is correct, we would have all countries in the region in the "first phase". The above analysis shows that the countries from the region face different problems - countries with sustainable balance of payments have moderate but steady rate of growth, in contrast, countries with high external deficits experience intensive growth, followed by a larger decline. It can be concluded that the main challenge for these countries today, including Bulgaria, is to achieve a moderate and sustainable growth through targeted policies to eliminate the causes of imbalances.

#### 4. CONCLUSIONS FOR BULGARIA

The main conclusions of the report are that the dynamic growth of the Bulgarian economy is due to dramatic increase in domestic consumption at the expense of lower savings in the economy. The growth rate of consumption exceeds both the growth rate of GDP and exports. Under the CBA, the increased consumption leads to an increase in inflation, which in turn is causing real appreciation of the Bulgarian currency. As a result, imports into the country are several times higher than exports. The inability of the manufacturing sector to increase its capacity with the rate of consumption results in significant external debt.

Although a strong inflow of FDI is observed, abrupt withdrawal after 2008 clearly demonstrates their "speculative" nature. The analysis of foreign direct investment to the country shows their concentration in sectors serving the domestic market - trade, real estate, financial intermediation, construction. The state of the banking sector in the country also contributes to the inflow of foreign capital into the country. The combination of favorable interest rates, foreign profile of the banking sector and reduced propensity to saving, results in a boom in lending. Measures to limit crediting taken by the state only increase the flow of foreign capital into the country.

The adjustment of the balance of payments in 2009 and 2010 leads to recession and slow recovery process, due to the lack of tools for immediate crisis response in the currency board arrangement.

The exchange rate regime introduced in Bulgaria in 1997 has unarguable beneficial effect on the Bulgarian economy only in the first years after its introduction. However, the currency board is not a panacea for the economic and structural problems in the country. The absence of structural reforms in the period leads to a reversal of the initial positive effects of the CBA. Its effects after 2003 could be defined as negative, as it plays a significant role in reducing the competitiveness of Bulgarian exports, strengthening the imbalances in the growth period. Additionally, the reduction of imbalances during the crisis has much more severe negative effect on the economy in fixed exchange rate environment, rather than in a more flexible regime. Now, 16 years after the introduction of the currency board in Bulgaria, the successful economic recovery and long-term growth of the country depend on the revision of the basic policies of the country and re-evaluation of the effects of the currency board. In any case, the choice that will be made should take into account the real situation in the country and the main advantages and disadvantages of Bulgarian currency board arrangement.

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## THE ROLE OF INTERNET IN ECONOMIC DEVELOPMENT OF VIKOS – AOOS NATIONAL PARK, GREECE

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### ABSTRACT

Nowadays, the Internet, apart from a channel to collect information of all kind, it has also become a means of promotion and consequently, an effective business tool. The Internet and the ICT's are effective strategy development tools, based on the interactive presentation of local information and the provided services for retrieving information about relative sources. The use of web-based tools, such as the website, can improve the communication level and the region recognition. The website provides a great spectrum of information for any sector. The National Parks in Greece need to get advertised due to their huge ecological importance. The existence and the conservation of these protected areas enhance economic development by attracting tourists. Vikos – Aaos National Park with the spectacular Vikos Gorge is one of the most-visited Greek National Parks. Through the Internet, which is one of the most appropriate means in data dissemination, the promotion of the protected areas not only can inform people about our natural heritage, but also attract visitors. This paper studies and analyzes websites concerning Vikos – Aaos National Park, assesses the Internet model adoption using e-services from these websites and to classify them in the four maturity stages of ICT adoption. The websites were analyzed as to their qualitative and quantitative characteristics. Then, the websites are classified in maturity stages starting from a simple presence of the entity in the Internet to the total ICT integration through multiple e-services provision according to content characteristics accomplished by the websites. Furthermore, the websites are ranked in order of superiority using the method of PROMETHEE II. Finally, some necessary recommendations for optimizations of the websites are made.

### KEYWORDS

Internet, Websites, Vikos - Aaos National Park, Economic development, Website assessment, PROMETHEE II method.

### JEL CLASSIFICATION CODES

- C65 – Miscellaneous Mathematical Tools
- O32 – Management of Technological Innovation and R&D
- Q56 – Environment and Development

## 1. INTRODUCTION

### 1.1 Background and Objectives

Internet is an exceptionally dynamic environment, continually developing and as it has become a major resource in modern business, many enterprises have already created their web presence (Andreopoulou et al., 2011). Since dynamics of conducting business is changing, all over the world, internet is becoming the major source to promote business and products (Pandey, 2012). Enterprises and individuals have become more familiar to do business as and when they like, thus long-established enterprises in all areas of interest are continually searching for internet-enabling their products and services (Krueger & Swatman, 2004). The Internet acts as the provider of numerous - yet continuously increasing and renewable - services and knowledge through the World Wide Web that constitutes an open society of servers and users on the Internet (Andreopoulou et al., 2006). Internet provides new perspectives within the social, financial and cultural development (Andreopoulou et al., 2012a).

Information and Communication Technologies (ICT's) during the last decade have successfully created new possibilities globally, while various new products and services continuously appear in international markets (Koutroumanidis & Andreopoulou, 2009). Nowadays, ICT has introduced the convergence of electronic services (e-services) - broadband network infrastructure - wireless technologies and mobile services. This confluence resulted in a combination of devices, products, tools, services and technologies with enhanced social network abilities that are greatly recognized 24/7, almost globally in all sectors of human life (Andreopoulou, 2012).

Everyone can profit from various e-services provided through the WEB and new opportunities emerge concerning economic growth, better health, improved service delivery, learning through distance education models, and social and cultural advances (Hull, 2003; Sealy, 2003; World Bank, 2003). New ICTs have disrupted many traditional forms of community but enabled the emergence of new ones (Connery & Hasan, 2005; Andreopoulou et al., 2007). Information and Communication Technologies are now a major part of Europe's economic growth strategy (EU, 2013).

Organizations are more and more required to incorporate new technology into business practices to improve competitiveness and bridge the gap between the production site and the final users of the products (Shan et al., 2008). Traditional manufacturing and service environments have been transformed into more physically distributed enterprise environments, which include supply chains, e-commerce and virtual enterprises (Gunasekaran & Ngai, 2007). The firms tend to participate in the internet society as the benefits are high and the electronic systems are ready to serve customers all over the world 24 hours per day 7 days a week (Andreopoulou et al., 2012b), while the cost keeps decreasing.

For consumers, Internet can reduce clutter, which could mean that content will more closely match their interests; while for sellers it facilitates a one-to-one marketing approach, allowing them to target each individual with a specific message (O'Connor, 2007). With the Internet becoming a viable alternative marketing channel and business exploiting the power of electronic networks, many service components have been transformed to e-services (Rust & Kannan, 2002). ICT applies to many issues of modern life and supplies information practically and simply (Feng et al., 2005), such as tourism industry.

Tourism is one of the main industries in Greece that stimulates economic development in industries from hospitality, transport, construction and retail, to small businesses such as restaurants, bars and tourism agents (Tsiotsou, 2006). It has become a significant source of foreign exchange revenues (Economic and Social Commission for Asia and the Pacific, 2007). Tourism industry, which involves the hospitality industry as a significant component, has become the world's largest industry and the long-term global growth projections are greater than for any other industry (The World Travel and Tourism Council, 2001).

Regarded as an economic sector, tourism has been defined as (The Scottish Parliament, 2002) "the sum of those industrial and commercial activities producing goods and services wholly and mainly consumed by foreign visitors or domestic tourists". Tourism's current role in expanding economic opportunity in developing countries presents a paradox. Resolving this paradox offers tourism enterprises the potential to play a leadership role within the industry and the business community as a whole (Ashley et al., 2007).

Different types of tourism contribute different types and levels of economic development. One of the most popular types of alternative tourism in Greece is the nature based tourism. According to United Nations World Tourism Organization (UNWTO, 2000), nature based tourism means "all nature-based forms of

tourism in which the main motivation of the tourists is the observation and appreciation of nature as well as the traditional cultures prevailing in natural areas". Nature based tourism development is one of the appropriate economical development forms in territories of national parks (Berzina & Livina, 2008). Natural Park is a natural area of land and/or sea, designated to protect the ecological integrity of one or more ecosystems for present and future generations, exclude exploitation or occupation inimical to the purposes of designation of the area and provide a foundation for spiritual, scientific, educational, recreational and visitor opportunities, all of which must be environmentally and culturally compatible (WDPA, 2007).

The importance of Internet in the tourism industry has increased dramatically in the past decade (Avcikurt et al., 2011). ICT has the ability to impact the whole tourism value chain (e.g. information on destination, accommodation, transportation, package tours and services) and affect process management and service delivery in the global tourism sector (Hinson & Boateng, 2007). As information is the lifeblood of the travel industry, effective use of IT is pivotal for marketing and promotion-related activities (Wang & Fesenmaier, 2006). Internet creates business opportunities (Vrana et al., 2006), as it has been extremely important for the promotion and increase in sales of the enterprises (Tsekouropoulos et al., 2011). According to recent studies, the internet is most effective when used as an advertising and marketing tool (Cai et al., 2004; Garces et al., 2004; Law & Hsu, 2005; Lee et al., 2006; Bui et al., 2006; Buhalis & Law, 2008).

## **1.2 The Role of Web Presentation in E-commerce and E-marketing**

There are many new web-related tools available to provide e-services in e-commerce (Singh, 2002) and e-marketing. E-services could be defined as "an act or performance that creates value and provides benefits for customers through a process that is stored as an algorithm and typically implemented by networked software" (Hofacker et al., 2007). These tools can be applied in innovative ways to offer online services to customers in e-commerce (Singh, 2002) and e-marketing. Technology is an enabler in e-services and not an end in itself (Rust & Kannan, 2002).

E-marketing can be defined as the use of internet and related digital technologies to achieve marketing objectives and support the modern marketing concept (Eszes, 2010). It includes both direct response marketing and indirect marketing elements and uses a range of technologies to help connect businesses to their customers. E-marketing is a subset of e-business that utilizes electronic medium to perform marketing activities and achieve desired marketing objectives for an organization. E-Marketing, Interactive Marketing and Mobile Marketing, are all a form of E-marketing (Petrovic, 2010). E-marketing gives business of any size access to the mass market at an affordable price and allows truly personalized marketing. Specific benefits of e-marketing include (Department of Trade and Industry of United Kingdom, 2004; The National B2B Centre, 2011): global reach, lower cost, trackable-measurable results, 24-hour marketing, shorter lead times, a level playing field, personalization, openness, social currency and improved conversion rates. Together, all of these aspects of e-marketing have the potential to add up to more sales.

E-commerce represents a "highly pervasive innovation that is leading to significant changes in the traditional ways of doing business" (Prananto et al., 2003). E-commerce is the purchasing, selling, and exchanging of goods and services over computer networks, such as the Internet, through which transactions or terms of sale are performed electronically. E-commerce can be broken into four main categories: Business-to-Business (B2B), Business-to-Consumer (B2C), Consumer-to-Business (C2B) and Consumer-to-Consumer (C2C) (DigitSmith, 2006). E-commerce is also a subset of E-business.

The success of e-marketing and e-commerce for any enterprise is greatly dependent on the website design. Website quality has become a crucial factor in attracting online shoppers to visit a company's online store and learn about its products and services and in ensuring repeat purchases. It is evident that, if a commercial business-to-consumer (B2C) website is to successfully generate sales, that website must have features that appeal to potential buyers (Blake et al., 2005). The way to build a successful website is the key-point that all enterprises considering initiatives in the web have to face (Rosen & Purinton, 2004).

The growth of the competence in the corporate website to be used as e-shop has led professionals and academics to make efforts to explore and determine which are the key factors that influence the websites' success (Flavian et al., 2009). Some important factors to take into consideration for an enterprise while planning to set up an e-commerce Website can be the time needed for the development of the Website and also the costs. Usability of the Website is another primary concern. The usability of a user interface refers to

the smoothness and easiness with which a user is able to interact with a system without ‘thinking’ about it (Andreopoulou et al., 2009).

Studies have identified a number of specific Website features (actual or perceived) that impact Website appeal. Among these Website features are: security, vividness and its correlated riskiness, approval by referent others, like family or friends, feature organization, quality of content, price, recognizability and/or desirability of brand, and time delay/download speed (Blake et al., 2005). Other studies within websites evaluation have analyzed the functions or roles played by specific website features as they contribute to website appeal, such as seven functions impacting customer loyalty to a website: 1. customization, 2. contact interactivity, 3. ‘cultivation’ (i.e. provision of information/incentives to extend customer purchasing over time), 4. ‘care’ (operationally, features that keep customers informed of the availability of preferred products and/or of the status of orders, or that minimize service description), 5. provision of a structure to facilitate exchange of opinions/information, 6. product variety, 7. ‘character’ (i.e. text/graphics/slogans, etc. projecting an image or personality of the merchant) (Andreopoulou et al., 2011). Other functions include navigability, communication utility, responsiveness, entertainment value, convenience and flow. Interactivity has been widely proposed as a force for website appeal (Blake et al., 2005).

This paper aims to study the role of internet in economic development of a National Park. Furthermore, the websites, used as a tool for economic growth, that promote and advertise the Vikos-Aoos National Park in Greece are analyzed. It is also assessed the adoption of Internet model using e-services from these websites and they are classified in the four stages of e-services adoption. The websites were analyzed as to their qualitative and quantitative characteristics. Then, they were classified in stages starting from a simple presence of the entity in the Internet to the total e-services integration through multiple e-services provision according to content characteristics accomplished by the websites.

## 2. MATERIALS AND METHODS

Websites promoting the Vikos-Aoos National Park were retrieved in the Internet using various key words and combination such as ‘Vikos-Aoos National Park’, ‘Management Agency of Vikos-Aoos National Park’, ‘Vikos’, ‘Vikos Gorge’, ‘Aoos’, ‘Aoos Gorge’, ‘Epirus Region’, ‘Refuge of Vikos-Aoos National Park’, ‘Zagori’, ‘Municipality of Konitsa’, ‘Prefecture of Ioannina’, ‘Megalo Papigo’, ‘Mikro Papigo’, ‘Monodendri’, etc. They were retrieved using the large-scale hypertextual search engine “Google” which provides much more satisfying results than other existing search engines (Berry & Browne, 2005; Langville & Meyer, 2006).

Initially, qualitative analysis was performed to the collected websites in order to examine the type of common features found in these websites. There were various features introduced in the retrieved websites, aiming to promote the Vikos-Aoos National Park. These criteria were then used to describe variables  $x_1, x_2, \dots, x_n$ . The criteria that were used are described in Table 1.

Then a quantitative analysis was carried out, in order to examine the presence or absence of common characteristics. A 2-dimensional table was developed that examine the existence of criteria and common features, and the values of 1, for the existence, and 0, for the non existence of the criteria, were attributed to variables  $X_1$  to  $X_n$ , respectively.

Table 1. Variables attributed to e-services criteria to be achieved by the website

Variable	Characteristic / Criterion	Variable	Characteristic / Criterion
X <sub>1</sub>	Two or more languages	X <sub>16</sub>	Links to other companies etc
X <sub>2</sub>	Information about products – services - activities	X <sub>17</sub>	Additional topics with information on different categories
X <sub>3</sub>	Contact information	X <sub>18</sub>	Downloadable files
X <sub>4</sub>	Local information	X <sub>19</sub>	Calendar application
X <sub>5</sub>	Digital map	X <sub>20</sub>	Event calendar application
X <sub>6</sub>	Audiovisual material	X <sub>21</sub>	Celebration calendar application
X <sub>7</sub>	Live web camera	X <sub>22</sub>	Social media sharing
X <sub>8</sub>	Search engine	X <sub>23</sub>	Social media profile
X <sub>9</sub>	Sitemap	X <sub>24</sub>	Forum
X <sub>10</sub>	Updated enterprise information	X <sub>25</sub>	Related sources of information
X <sub>11</sub>	Online survey	X <sub>26</sub>	Third person advertisement
X <sub>12</sub>	Online communication form	X <sub>27</sub>	Newsletter
X <sub>13</sub>	Weather forecast	X <sub>28</sub>	RSS
X <sub>14</sub>	Website visitor tracker	X <sub>29</sub>	Code access
X <sub>15</sub>	Frequently Asked Questions (FAQ)	X <sub>30</sub>	Personalization of the page, trace, safety

## 2.1 Classification of Websites in the Four Stages of E-services Adoption

The websites were further classified in four (4) categories, each one representing a stage of usage of e-commerce and the stage of e-services adoption. Various researchers have described a four stages adoption model (Gossain & Kenworthy, 2000; Rao et al., 2003) that represents four different distinctive categories or adoption stages for an enterprise with varying strategic objectives and aspirations. Thus, stages start from simple web “presence” and gradually increase the employ of e-services as to the total integration or transformation. These stages are: presence, interaction, transaction and transformation. The grouping depends on the criteria achieved by a website. These stages can also identify the stages of maturity for these websites regarding the enhancement of e-business.

“Presence” is the stage that ensures that the website is accessible in many ways by all users that want to visit the website and interact with the interface in order to gain information. It is only ensured a presence in the Internet and advertisement purposes. “Interaction” addresses the engagement of website visitors and enables them to complete whatever process or experience offered by the website. Therefore, in the second stage of interaction, beyond the presence, there are some limited actions enabled for the user, such as navigation through the website and the provision of various links. “Transaction” is related with the e-shoppers experience in the purchasing process and payment orders. Thus, in the third stage of transaction there are enabled applications that enhance transactions where the final user can play a major role, such as electronic exchange of texts and self-services provided for the user. “Transformation” includes the quality of communication and transaction along with responsiveness and reliability to the potential customers. Therefore, in the fourth stage of transformation the value chain is optimized while users have the possibility for online orders and payments while they are simultaneously in position to check the stage of their order.

According to that method, websites that achieve  $t \leq 4$ , only one to four (1-4) criteria, are classified in the stage of *presence*, while websites fulfilling additionally five or 17 (a total  $5 < t < 17$ ) criteria belong in the stage of *interaction*; websites that accomplish 22 to 26 ( $22 < t < 26$ ) criteria belong in the stage of *transaction*, while websites accomplishing the majority or all of the criteria, a rate 27 to 30 ( $27 < t < 30$ ), represent the stage of *transformation* (Andreopoulou et al., 2007; Andreopoulou et al., 2008).

### 3. RESULTS AND DISCUSSION

Research through search engines on the Greek Internet resulted in the retrieval of 45 websites that support and promote the Vikos-Aoos National Park in Greece. The achievement of each one of the e-services characteristics is presented in Figure 1.

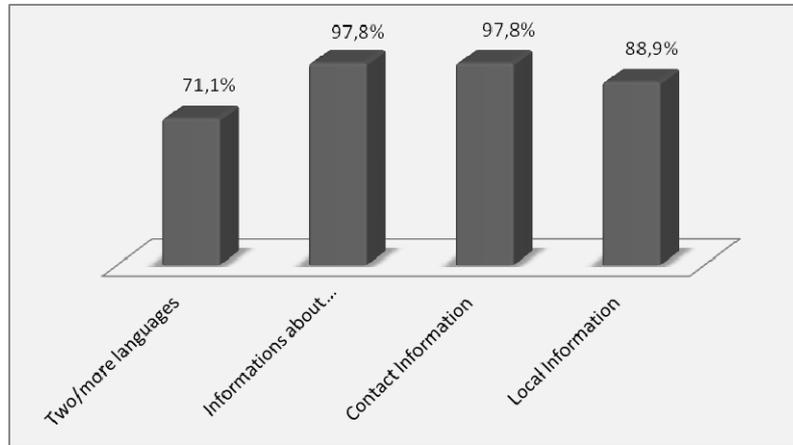


Figure 1a. Achievement of the criteria of the 1<sup>st</sup> stage

The characteristics of the first stage of e-services adoption are fulfilled satisfactorily by the websites. Almost all the websites that promote the Vikos-Aoos National Park fulfill both the second and the third criterion. Many websites provide useful local information (88.9%), while only the 71.1% of the websites can be translated into two or more languages.

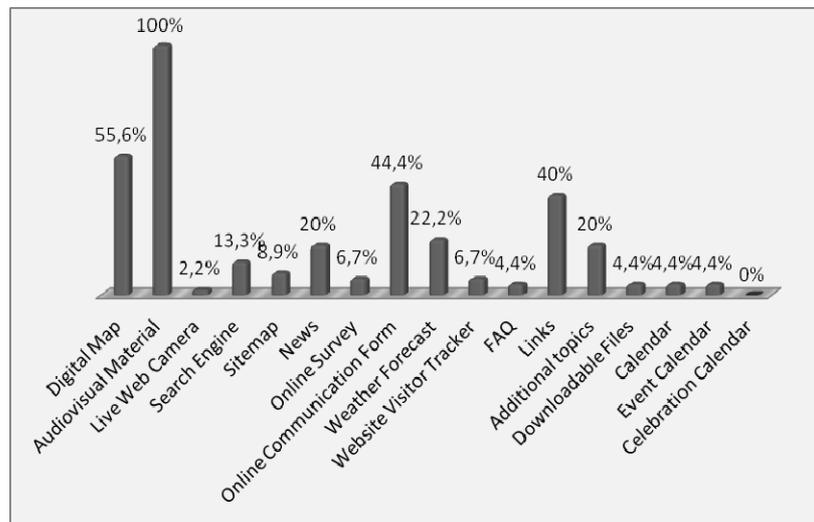


Figure 1b. Achievement of the criteria of the 2<sup>nd</sup> stage

Only a small percentage of the characteristics of the second stage of e-services adoption is fulfilled. The 55.6% of the websites provide a digital map ( $X_5$ ), while all the websites provide audiovisual material ( $X_6$ ). A small percentage of the websites (13.3%) offers a search engine ( $X_8$ ) and a further smaller percentage offers a sitemap ( $X_9$ ). Just the 2.2% of the websites provide live web camera ( $X_7$ ). The 20% of the websites is being updated continuously ( $X_{10}$ ), while almost half of cases offer online communication form ( $X_{12}$ ). Online survey ( $X_{11}$ ) is used by the 6.7% of the websites, while weather forecast ( $X_{13}$ ) is provided only by the 22.2% by the websites. However, links to other companies ( $X_{16}$ ) are provided by the 40% of the websites. The websites that offer website visitor tracker ( $X_{14}$ ), calendar ( $X_{19}$ ) and event calendar ( $X_{20}$ ) are only few. Frequently

Asked Questions ( $X_{15}$ ) are provided just by the 4,4% of the websites. Only the 1/5 of the websites provides information about different topics ( $X_{17}$ ). Any website doesn't provide calendar application ( $X_{21}$ ).

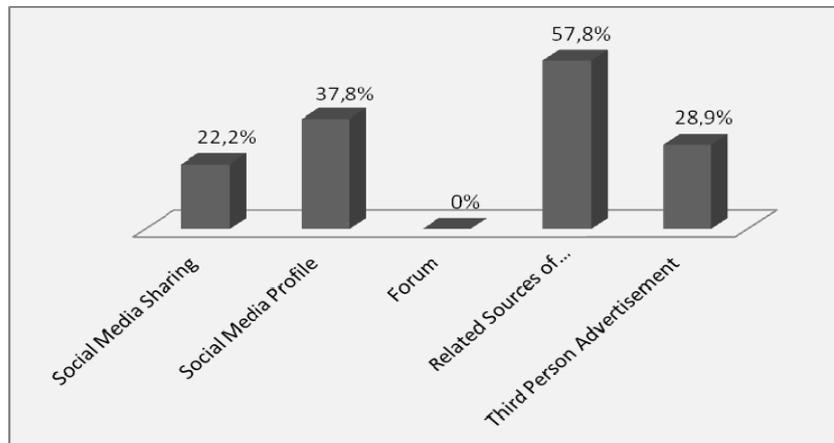


Figure 1c. Achievement of the criteria of the 3<sup>rd</sup> stage

As for the fulfillment of the criteria of the third stage of e-services adoption, there is a fluctuation. The 24<sup>th</sup> criterion (forum) isn't achieved at all. A small percentage of the websites offer social media sharing ( $X_{22}$ ), while a bit bigger percentage has created a social media profile ( $X_{23}$ ). The provision of related sources of interest ( $X_{25}$ ) is achieved by the 57,8% of the websites, while third person advertisement ( $X_{26}$ ) is made by the 28,9% of the websites.

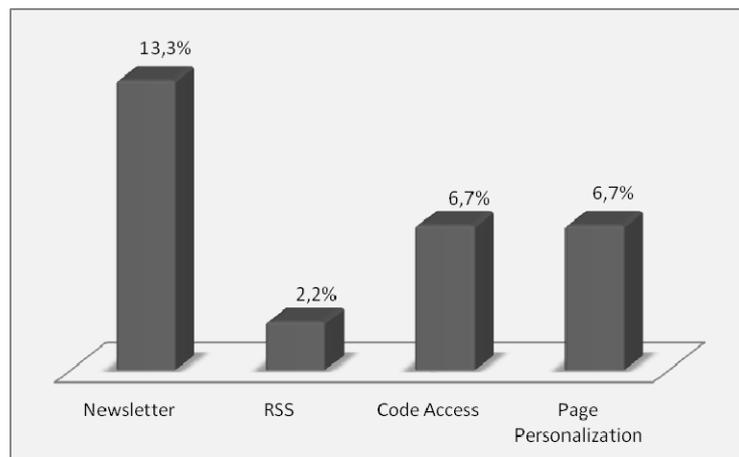


Figure 1d. Achievement of the criteria of the 4<sup>th</sup> stage

The characteristics of the fourth stage of e-services adoption are fulfilled in a small percentage by the websites. 13.3% of the websites provide newsletters ( $X_{27}$ ), while the websites that use RSS system ( $X_{28}$ ) are even fewer. Account creation ability ( $X_{29}$ ) and page personalization ( $X_{30}$ ) is offered by the 6,7% of the cases.

### 3.1 Classification of Websites in using E-Services

The classification of the Vikos-Aoos National Park websites in e-services adoption stages is presented in Figure 2.

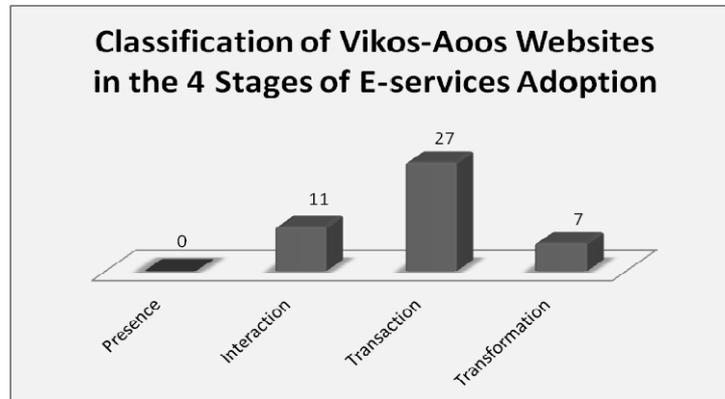


Figure 2. Classification of Vikos-Aoos National Park websites in the 4 stages of e-services adoption

Results show that most cases belong to the third stage of e-services adoption ('transaction') where online communities such as forums and social media are involved, while in the stage of 'transformation' are classified the fewest websites. 27 of the websites are classified in the interaction stage. In these websites, except of the information about the products – services - activities provided, there are enabled links to local information, similar websites and relative topics of information, aiming to finally convince the user to visit the Vikos – Aoos National Park. There is no website listed in the first stage of simple presence.

## 4. CONCLUSIONS

The research in the Greek Internet retrieved 45 websites that promote the Vikos-Aoos National Park in Greece. The existence of websites constitutes a first and very important step for the promotion of Vikos-Aoos National Park. There were identified 30 different features introduced in each website. The classification of these websites in 4 stages discloses the present situation of the adoption of Internet and e-services model in this sector in Greece. Most of the retrieved websites (27) are websites classified in the 'transaction' stage and that is a very optimistic finding as they accomplish 22 to 26 criteria.

These websites include apart from the informational material about the products - activities – services and the contact information, attractive information about the National Park with pictures, videos or maps, some links to related issues and the participation of the enterprise in social media.

However, given the public awareness for the protected areas and especially the National Parks, the current interest for the delivery of services through Internet and the improved broadband Internet infrastructure in Greece, the websites that promote Vikos-Aoos National Park should evolve in further e-service provision. Findings can be helpful for managers and policy makers while planning activities and implementing innovative technological changes, such as the functional and effective websites as also for web designers while designing website of similar interest in order to fulfil certain features and characteristics aiming to optimize the websites that promote protected areas and to generally improve effectiveness of e-services.

A future extend in this process will be users testing (heuristics inspection), to make sure that the sites match the consumers' expectations.

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# **MONITORING AND EVALUATION OF THE WATER AND SANITATION SECTOR PERFORMANCE: CASE OF ALBANIA**

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## **ABSTRACT**

Sustainable and equitable access to safe water and adequate sanitation are widely acknowledged as important development goals in the framework of Millennium Development Goals for economic growth and poverty reduction. Water and Sanitation interventions are multi-dimensional, multi sector and there is a wide spectrum of possible socio-cultural, economic, environmental, political and legal conditions in which services are delivered. Additionally, water and sanitation services in many countries are responsibility of the local government, which increases the demand for accountability in terms of increasing quality of services and improving performance. All these facts raise the need to monitor and evaluate water and sanitation projects and their impact to development goals, which is not easy considering the far reaching objectives of the water and sanitation programs. To date there are few impact evaluations showing water and sanitation programs efficiency in delivering many of the desired outcomes. The aim of this paper is to analyze the role of monitoring and evaluation of the water and sanitation performance. This will build on different studies and analysis performed and the data of International Benchmarking Network over the last 5 years. The study focuses on Albania because water and sanitation sector has benefited many development projects and policy development assistance and therefore, evaluating the sector performance is a good reference for scaling up new water and sanitation projects. For the purpose of this study a sector analysis of the water and sanitation in Albania is undertaken using data from the International Benchmarking Network database and the Benchmarking Albania database. The result of the analysis demonstrates that monitoring and evaluation of the water and sanitation sector performance can serve as a good premise for setting minimum standards of services for the whole sector and as a good tool for the Government to guide the necessary investments needed in the sector. The findings of this study are a good reference for those interested to study and make further analysis of the role of evaluation of water and sanitation projects in economic development and poverty reduction.

## **KEYWORDS**

Monitoring, evaluation, water and sanitation sector, performance, development goals

## **JEL CLASSIFICATION CODES**

H41, O18, O19

## **1. INTRODUCTION**

Water is an essential need for life and a vital element of the environment for sustainable development, therefore the proper management of water resources is an essential component of growth, social and economic development, poverty reduction and equality, all these important in the context of achieving the Millennium Challenge Goals. On a global level water is becoming a scarce resource and there are several factors that cause this phenomenon. Besides the already existing challenges in the provision of this service, in recent decades there are several factors causing water scarcity such as: increased water demand due to population growth, increased water use from industries and, pressures from global warming, increased food and energy prices, increased costs of research and development of water systems and outdated infrastructure.

All these reasons could explain why many countries today are pursuing water sector reforms aimed at sustainable development. These developments became part of the International Conference on Water and Environment in Dublin in 1992, where were defined the principles of water use and management. These principles determine that water is a limited resource, essential for life, development and the environment, has an economic value and its management should be based on a participatory model that includes planners, users and policy makers at all levels. Easter and Feder (1996) reached the conclusion that it is necessary a review of methods used to manage and allocate water according to the needs of customers and sectors.

Tortajada (2001) concluded that in the next decades water problems will increase and it will be required to analyze water in combination with other sectors such as agriculture, health, industry and environment. In this framework, the water will be seen in the context of the development of society, having as main objectives the reduction of poverty, sustainable development and environmental protection.

Governments and development partners share common goals to promote the objectives of the Millennium Challenge Goals, which were officially presented at the Millennium Summit. One of the objectives refers to ability of having safe water, adequate sewerage to improve the quality of life. Goal 7 aims at environmental sustainability stipulating that by 2015 the proportion of people without sustainable access to safe drinking water and basic sewerage services is halved.

Considering the development of a series of reforms and investments in the sector many countries are adopting comparative monitoring and evaluation indicators for the sector of water supply and sewerage. There are several reasons that justify this approach. *First*, decentralization and transfer of responsibilities to local government units requires an objective source of information about water and sewerage companies. *Second*, the presence of many donors and other international institutions raises the need for access to information to evaluate the effectiveness of their fund use. *Third*, the monopolistic nature of the water raises high demands for transparency and efficiency. *Forth*, the presence of many stakeholders with different responsibilities makes it necessary data monitoring for potential interaction of stakeholders on professional basis.

Today, many researchers perform in-depth analysis of the water sector, but few engage in research of water and sewerage companies (Berg & Marques, 2010). This study aims at analyzing the role of monitoring and evaluation for the performance of water supply and sewerage sector due to increased demand for information from interested stakeholders and importance this sector has for sustainable development and poverty reduction. The study focuses on Albania because water and sanitation sector has benefited many development projects and policy development assistance and therefore, evaluating the sector performance is a good reference for scaling up new water and sanitation projects. In Albania, there are very few studies that analyze the performance of the sector and in this context the use of data can serve as an incentive for further studies for those interested.

## 2. LITERATURE REVIEW

The purpose of this section is to present, synthesize information and compare different monitoring and evaluation systems which are used today by many organizations and/or governments. A special focus in this section is devoted to the monitoring system performance and benchmarking of the water and supply and sewerage.

OECD (2010) defines monitoring as "a continuing function that uses systematic collection of data on specific indicators to provide managers and stakeholders with information on the progress of their development programs in terms of objectives and resource allocation usage".

The purpose of monitoring and evaluation systems is to provide guidance on how data can be used to determine different levels of performance based on defined indicators. Though there are several models of monitoring and evaluation, these models are not substitutes of one another. Logical framework model, results based management, lifecycle project model and participatory monitoring and evaluation model could be used together or separate at different moments of the project lifecycle: planning, implementation and / or evaluation.

International monitoring and evaluation of the water supply and sewerage sector started in 1960 by World Health Organization, but was put in practice in 1977 after Water Conference of the United Nations which defined the period 1981-1990 as the Decade of Drinking Water and Sewerage, aiming at providing safe water

and sanitation for all by the year 1990. In this period, the data were gathered by governments alone being main provider of this service and progress reports were prepared by water supply and sewerage agencies, or involved ministries such as ministry of health etc. This process was criticized by international institutions due to the lack of international standardized indicators, or lack of indicator definitions, which limited accuracy and comparability of data (Cotton & Bartram, 2008).

Basic research and evaluation model is usually used for basic data collection. This model does not apply to the collection of huge data due to cost and time constraints, but can provide detailed information for a period of time for small series (Stem et al., 2005). Status evaluations are used to provide basic information in a certain period of time and when repeated are used to indicate trends. The challenges of status evaluation are: high cost, aggregated data using regression, big size of champion and difficulty to determine causality (Stem et al., 2005).

Logical framework model forms the basis for a convincing story of the program's expected performance, telling stakeholders and others the problem the program focuses on and how it is uniquely qualified to solve it. The elements of the model are logical resources, activities, products, short-term and intermediate and long-term results (Wholey, 1983.1987). Several other authors have added clients reached, as well as relevant external contextual influences (McLaughlin & Jordan, 1991). Some organizations use the logical model because it is a clear structure that connects directly indicators to assumptions. Logical framework model has been criticized because of the lack of flexibility and the ability to reflect complex social issues (Jacobs et al., 2010).

Project lifecycle model is widely used during the phases of project implementation where monitoring is performed at every step of the process (Woodhill, 2000). Results based management integrates the logical framework and project life cycle management approaches into a harmonized monitoring system where it provides linking of interventions to impact, efficiency and it provides effectiveness comparisons for financing purposes. The weaknesses of this model are that some processes and intermediate steps that do not fall within the project life cycle may be ignored (Stem et al., 2005).

Participatory system has become more widespread nowadays. It is a methodology that includes the beneficiaries to make them part of the data collection and analysis process and this way allows the use of collected results (Jacobs et al., 2010). Since the number of participants is large, this system requires more resources and although the results are objective there are difficulties to aggregate results with other collected data in more standardized systems.

M & E systems analyzed so far, despite differences have common principles. All these approaches deal with performance evaluation by introducing data in a defined system and producing relevant results (indicators) in order to measure the effectiveness of activities or work processes. The differences of these systems consist of: the purpose of the monitoring, stakeholders involved in the process of data collection, indicators used, time / frequency at which monitoring is performed and / or steps followed during the monitoring process and way of using results. Despite the advantages these systems offer they cannot apply separately to evaluate the performance of a single sector such as water supply and sewerage.

As a result of undertaking a series of reforms and sector investments many countries have adopted monitoring and comparative evaluation of performance indicators for water supply and sewerage sector, including Albania through the so called "Benchmarking". Over the past 20 years overall the essential role of Benchmarking for the development and implementation of policies in the water and sewerage sector has received a very large development. Organizations such as the International Water Association, International Benchmarking Network, USAID, etc have built their own methodologies and clear programs for monitoring and comparative performance evaluation.

Today, many researchers perform in-depth analysis of the water sector, but few engage in research of water and sewerage companies (Berg & Marques, 2010). These researchers go even further and reach the conclusion that the number of journals that publish benchmarking water studies is low, although the figure has increased from 6% to 11% of the total number of published studies.

## **2.1 Role of Comparative Data for Water and Sewerage Sector**

Today the number of quantitative studies which analyses the factors that lead to efficiency of water supply and sewerage companies has increased.

Economies of scale are debated especially for water and sewerage companies in developing countries that have the following characteristics:

1. Companies are inefficient and therefore the services provided are not qualitative. These companies are not able to carry out investments to repair older systems, or to maintain existing systems;
2. Due to the impossibility of carrying out necessary investments, the services in poor or remote areas cannot be provided. This leads to inequality in service delivery and environmental pollution;
3. Poor performance of companies exerts pressure on the Government, which is obliged to offer subsidies. The debate around this particularly from international institutions is that Governments offer more subsidies for operating costs and very little is done to allocate to people in need.

Comparative data through benchmarking methodology help to perform sector analysis using data from all companies. Berg and Marques (2010) were able to collect 47 studies that deal with the existence of economies of scale, and in particular the optimal size of the company to achieve these economies. A number of studies have proved the existence of savings that come as a result of aggregating two or more companies which provide water and sewerage services to a larger number of populations. The debate conducted nowadays regarding economies of scale is determining the limit after which the benefits are not realized

Tynan and Kingdom (2005) have used data from high low and medium developing countries and analyzed the relationship between company size and cost per unit of production. The result was that water companies can reduce operational costs per customer by increasing the scale of production. The study pointed out that economies of scale are better realized for small size companies that serve less than 125,000 consumers than for large companies to which economies of scale begin to decrease after a certain point.

Another benefit that comes from benchmarking is related to the role that the regulatory framework has in the efficiency of the sector. Berg and Marques (2010) identified 21 studies and concluded that the supervisory rules have improved the efficiency and productivity of water companies based on previous regulatory methods. Other studies reflect stricter regulatory methods using benchmarking as a method to determine tariffs or monitor the quality of service, arguing that in this way public interest may be protected.

Finally, benchmarking serves to measuring efficiency at the regional level, or to compare different countries using several indicators of efficiency. There are 66 studies carried out in the sector of water supply and sewerage analyzing benchmarking to measure the relative efficiency of water companies in a particular country, region or cross country champion (Berg and Marques 2010). Studies address issues such as quality of service, financial sustainability and economic efficiency factors. Similarly, there are studies that analyze the environmental and economic performance of scarce water resources. These issues need more attention in the future. In some studies researchers have used quality of service as a criterion for categorization of companies with the aim of developing incentive framework (Berg & Lin, 2008).

These researchers have found that few analysts engage in constant research in this area: 213 researchers have published 120 articles. This shows that the performance of the water and sewerage companies is not a high status activity. This observation stands in contrast when we consider the importance of the sector for the economic development and social welfare. It is evident that the validity of the data affects the trend of publications. Increased quantitative studies in recent decades came as a result of increased access to transparency of required data in these countries.

Since water supply and sewerage sector is important for public policy of the country, it increases interest of performing in depth studies on performance. Considering the specifics of linkages this sector has with other sectors such as health, agriculture, energy, would be recommended that in the future studies include external factors that are beyond the current management such as political constraints, etc. At the same time benchmarking can help to address and assess the impact of various public policies such as decentralization, public-private partnerships, etc. In Albania, there are very few studies that analyze the performance of the sector and in this context the use of data can serve as an incentive for further studies.

### **3. METHODOLOGY**

For the purpose of this study 57 water and/or sewerage companies in Albania are analyzed for the entire period 2006-2011 considering the currently available data as documented in the Performance Monitoring and Benchmarking Program administered under the Albanian General Directorate of Water Supply and Sewerage. This data analysis has the main purpose to analyse the performance of the sector over a 5 year

period. The data for year 2012 has not yet been published by the Albanian General Directorate of Water Supply and Sewerage, therefore are not included in this study.

The Study considers 7 performance indicators that have a serious impact on the financial sustainability on water and sewerage Company namely:

- Number of Staff per 1000 water plus sewerage connections and continuity of service;
- Total operating cost per cubic meter water produced, sold and average price;
- Total operating cost coverage by Revenues, Collections and Subsidies
- Direct operating cost coverage based on revenues and collections;
- Proportion of metered connections and water sold that is metered;
- Production, Sale and non revenue water;
- Water coverage and sewerage coverage.

#### **4. PERFORMANCE MONITORING AND EVALUATION OF WATER AND SEWERAGE SECTOR IN ALBANIA**

Benchmarking is implemented in Albania since 2005 and consists of measuring and monitoring ongoing performance of water supply and sewerage systems and evaluating their progress. This assessment is made on the basis of some standard indicators the methodology uses in terms of technical, financial, management & service quality aspects. This section aims to analyze the reasons which have led to the use of this methodology in the case of Albania, main actors involved in the sector, as well as to present the current performance situation of 57 water supply and / or sewerage companies through key indicators.

In Albania operate 58 water and / or sewerage companies, but until 2011 data were for 57 water and/or sewerage companies. Of these only two are public enterprises in the process of transformation into a joint stock company. Water companies were previously owned by central government, but in 2007 all companies were transferred to local government ownership in the framework of the decentralization process.

The law no. 8652 dated July 31, 2000 defines the service of water supply and wastewater as a function of local government units (LGU). LGU's have the right to provide these services with a variety of ways including the creation of own companies / enterprises, individually or jointly with other LGU, and by signing contracts with public or private operators. Law no. 8744 dated February 22, 2001 (revised by law no.9561, dated 12.6.2006 and law no.9797, dated 23.7.2007) stipulates the transfer of immovable properties to local government units.

##### **4.1 Parties involved in the provision of water and sewerage services in Albania**

The water supply and sewerage sector is complex, not only by nature of the sector, but by numerous stakeholders who should coordinate and take decisions on the basis of the mandated authority they have.

**1. Water supply and sewerage companies.** These companies are organized as joint stock companies under the Corporate Law, but the joint ownership complicates their governance as corporate. Shares of the company are in custody of local government shareholders, while assets and liabilities are in the ownership of the company itself. Shareholders are represented by a General Assembly of Shareholders, which is the same as municipal councils / municipal local governments, in the case when the company serves a single LGU. Water Company management becomes more complex when two or more LGU share the ownership. This institutional structure presents difficulties because the LGU's have little experience in performing supervisory role over companies.

**2. Ministry of Transport and Communications.** Policy functions, service assurance and regulatory framework are divided and mandated among different institutions and levels of government. Policy formulation is the responsibility of central government. The Ministry of Transport and Communications is responsible for policy and strategy formulation, investment planning and allocation, as well as monitoring and comparing the performance of the sector. Sector policies and strategies, which are formulated at the line ministry level, serve as basis for the laws adopted by Parliament and other legal acts adopted by the executive.

**3. Water Regulatory Authority.** The regulatory framework of water and sewerage is the responsibility of the Water Regulatory Authority, an independent regulator in the central government level according to law no. 8102 dated March 28, 1996 revised by laws no. 9352 and 9915. Among the competencies of this entity are: (i) approval of tariffs; (ii) definition of performance and service standards for licensed companies; (iv) preparation of methodologies for tariff setting; (v) setting of standards for investment programs and sale of assets; (vi) reporting to the Government on the situation of water and sewerage sector based on information received from companies and (vii) organizing public hearings whenever deemed necessary by ERE.

**4. Central Government,** which provides subsidies for water supply and sewerage companies to cover financial deficits of the companies. Subsidies are high and they are offered primarily to cover operating costs preventing their use to cover extra costs of people in need.

The existence of numerous actors in the sector shows the complexity of its management and the need for measuring key performance indicators to ensure coordination on professional basis and appropriate policy formulation process. This makes necessary the use of comparative data through Benchmarking methodology of water supply and sewerage sector.

## **4.2 What are the reasons for the use of Benchmarking in Albania?**

*First,* decentralization and the transfer of responsibilities of water supply and sewerage services to local government units requires an objective information source for the water supply and sewerage companies. Local government as legal owner of companies needs to have access to the information so that the relationship between the owner and providers of these services builds on professional basis.

*Second,* in Albania for many years donors such as World Bank, KfW, USAID, etc. have invested in water supply and sewerage sector, and in this context, these stakeholders need information to know how their funds are spent and as a result to measure the effectiveness in order to determine future directions of their funding in the sector. Similarly, in the case of investments through loans lenders require information on how their credits have been used. The attention of the International partners has been drawn to the water and sewerage sector in Albania because problems and failures caused seem to be the main threat to macroeconomic stability, sustainable growth and poverty reduction. Moreover, the sector of water supply and sewerage is linked to the performance of other sectors such as: health and environment. Funding from donors and other international partners has been the main source of investment in this sector. Leading donor in this sector is Germany with 32.8%, followed by Italy 11.5%, EU 10.6% and 7.8% World Bank (World Bank, 2011).

*Third,* water supply and sewerage services are monopolistic by nature and as a result on one hand there is high demand for transparency and efficiency, and on the other hand there is requirement for proper policy formulation increasing the need for more detailed information.

*Fourth,* benchmarking is used by both water and sewerage companies to improve performance and regulators to set tariffs or asking service providers to improve quality. Prices charged by companies for water services are often below full cost of providing these services. Full coverage of costs including maintenance and operating costs, as well as investment costs should be a long-term objective for public companies because it provides them financial autonomy. In this context this methodology helps regulators to determine tariff structure, which should be in line with the improved services.

### **4.2.1 Current Situation of Performance of Water and Sewerage Companies in Albania**

Performance of water supply and sewerage companies is poor as shown by performance indicators in this sector. Companies generally face more or less same problems, regardless of their level, which varies from one city to another.

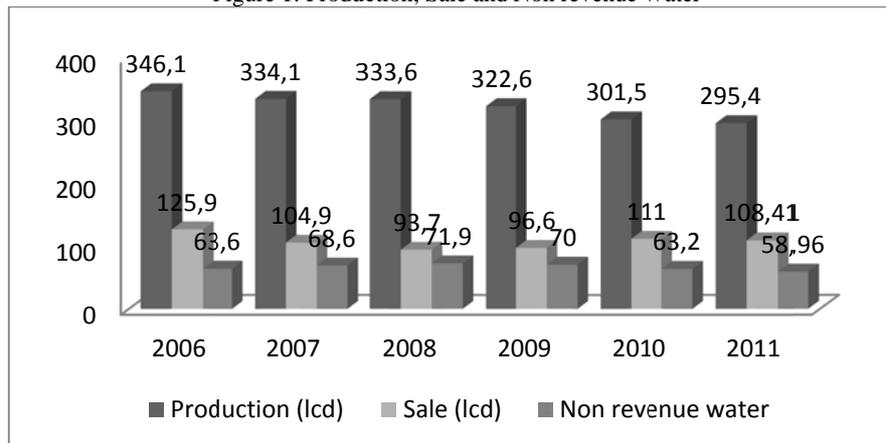
Some of these problems are as follow (General Directorate of Water Supply and Sewerage, 2011):

- Relatively low level of water supply: 86% overall coverage;
- Major loss of water due to amortization and large amounts of unaccounted water. The rate of loss (the produced water which enters the system, but does not generate any income) is 60% while same figure in Western Europe at 20%. This is caused because the level of metering installation is low at less than 50% of links and at the same time there are illegal connections to the network;
- Wastewater service coverage is 61% in general;

- Drinking water rates are at low levels that cannot afford the cost. Financial productivity of labor is 1.19, which means that operating costs are 19% higher than income. While this figure in Western Europe is 0.50;
- Continuity of water supply is 11 hours, while same figure in Western Europe is at 24 hours a day. Only two water companies (Korca and Librazhd) can provide 24 hours water pressure (Albanian Ministry of Public Works and Transport, 2011).

The following section presents the trend of the main technical, financial and quality of services indicators for the period 2006-2011. As previously mentioned the official data for 2012 are not yet published by the General Directorate of Water Supply and Sanitation in Albania (Database of Benchmarking) and therefore could not be included in this study.

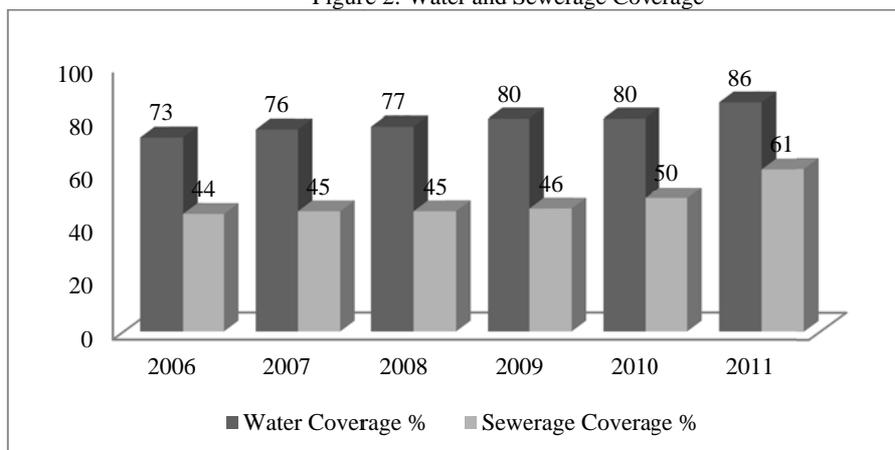
Figure 1: Production, Sale and Non revenue Water



Source: own graph, Database of Performance Monitoring and Benchmarking Program, 2006-2011

The above figure reflects the production and sale of water through appropriate indicators, calculated per head of the population served, as well as non revenue water calculated as percentage of non metered water to produced water. According to this graph, the production has had a positive trend since has been reduced from 2006 to 2011 by an average of 50 liter /capita /day. This reasoning is relevant in the case of Albania where it is produced more than demanded. High percentage of water that brings no revenues impact the inefficiency of companies making it difficult for the Water Regulatory Authority to approve tariff increases. Albania is still far from the international standard for unpaid water which is 20%, although there is positive experience like Singapore where this figure is 4% (World Bank, 2011).

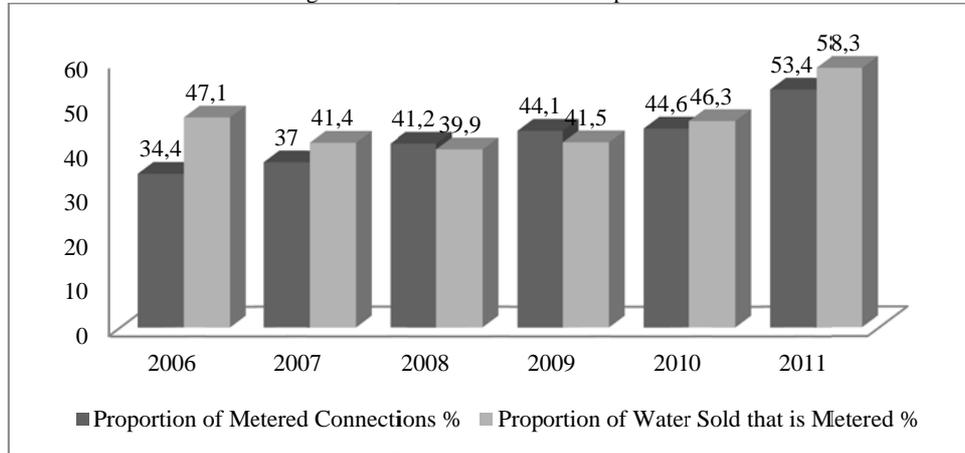
Figure 2: Water and Sewerage Coverage



Source: Own graph, Database from Performance Monitoring and Benchmarking Program, 2006-2011

As can be seen from figure 2 from year to year the service area both for water supply and sewerage has been expanded. In the positive trends of these two indicators have influenced the investments made in the sector both from the state budget and foreign investors. It is also evident that an increase in population served normally associates with an increase in the density of the population, which contributes to efficiency.

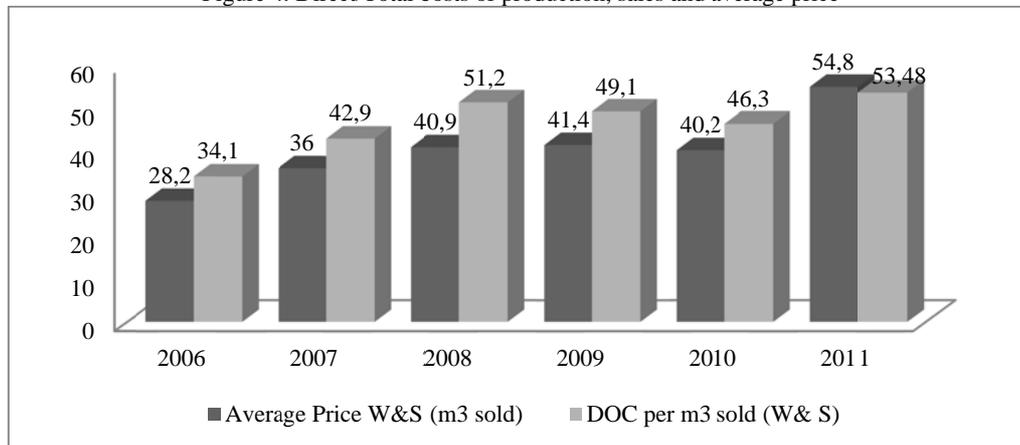
Figure 3: Level of Water Consumption Measurement



Source: Own graph, Database from Performance Monitoring and Benchmarking Program, 2006-2011

In figure 3 is presented the proportion of water sold that is metered and the percentage of metered connections. The indicator of water consumption measurement expressed as the number of connections equipped with water meters has positive trend. Meanwhile, the percentage of the volume of water sold does not follow straight tendency as with increase of meters installed. This may be due to the tendency of water savings by customers equipped with meters.

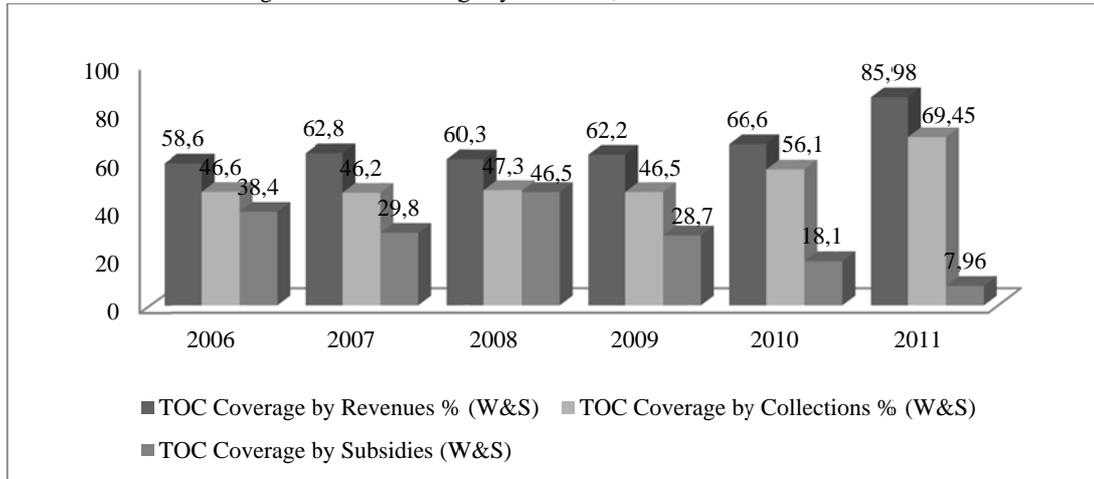
Figure 4: Direct/Total costs of production, sales and average price



Source: Own graph, Database from Performance Monitoring and Benchmarking Program, 2006-2011

As seen from figure 4 the difference between the average price and direct operating cost (DOC) has a positive trend. The difference between the price and DOC has been reduced from 10 leke/m<sup>3</sup> in 2008, to 1 Lek/m<sup>3</sup> in 2011. In 2011 the difference is positive, as the price can cover the direct operating cost. But it should be noted that this situation may be advantageous for some water and sewerage companies that serve a larger number of population.

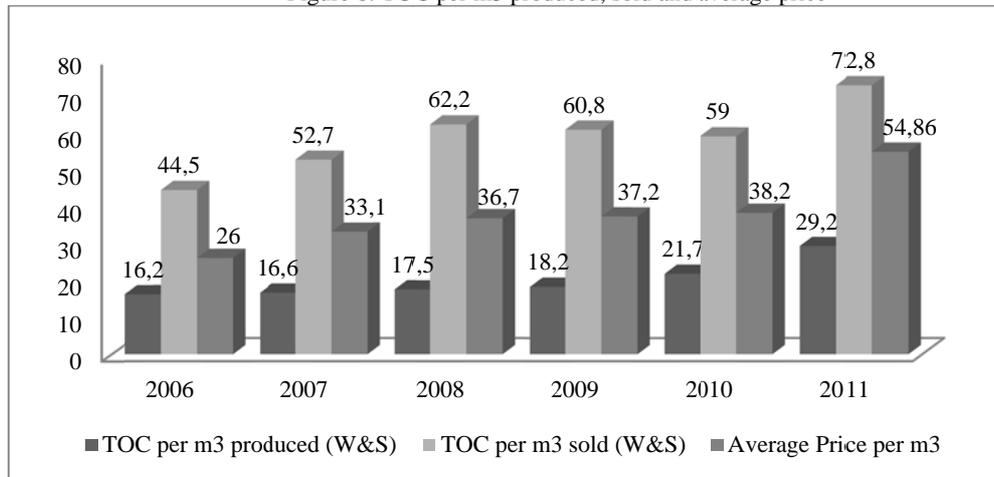
Figure 5: TOC Coverage by Revenues, Collections and Subsidies



Source: Own graph, Database from Performance Monitoring and Benchmarking Program, 2006-2011

In figure 5 it is observed that the ratio of total operating cost coverage by collections has been increased narrowing the difference for uncollected bills. It is also apparent that the part of total operating cost covered by subsidies is being reduced, but at the same time it has increased the share of the remained uncovered costs. This indicates that the financial loss from the year 2006 to 2011 has increased showing a potential negative trend of the sector from the financial point of view.

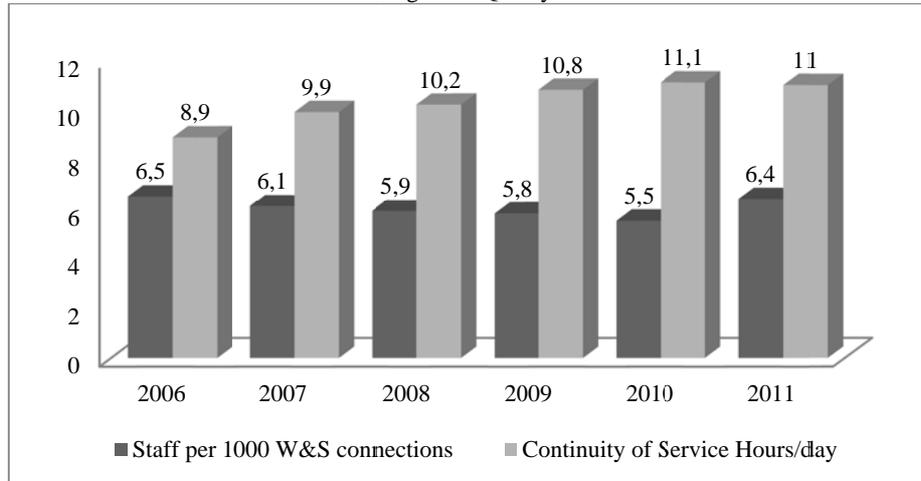
Figure 6: TOC per m3 produced, sold and average price



Source: Own graph, Database from Performance Monitoring and Benchmarking Program, 2006-2011

As it can be observed from figure 6 the cost of production has an upward trend which is negative. Total operating cost of sales has increased until 2008 and then declines until 2010 to be increased again in 2011. Given the fact that the prices are still very low and far for the cost of sales, still their performance has a positive trend, as the average price has increased, while the difference between price and cost of sales has been narrowing. The worst situation in terms of cost of sales appears in year 2011 were such costs have increased, but if we analyse the average price it has increased significantly since 2010, narrowing the difference between cost of sales and average price.

Figure 7: Quality of Service



Source: Own graph, Database from Performance Monitoring and Benchmarking Program, 2006-2011

An important aspect of performance is the management of human resources and quality of service. The above graph reflects the positive trend of increased average hours of water supply from 8.9 hours in 2006 to 11 hours in 2011. Despite the positive trend of this indicator, the sector is still far from the international standard of 24 hours / day. Likewise, the indicator of the number of staff per 1,000 connections has decreased except in 2011 where there is an average increase. However, there is still work to do to reach Western European standard for 2 staff per 1,000 connections.

All above indicators reflect the trend of the performance of water supply and sewerage sector in Albania. As seen from the graphs many indicators have improved, but some of them are far from international standards. Improved performance of the sector is also a priority of the Albanian Government as defined in the National Strategy Sector Water Supply and Sewerage Services for 2011-2017. The debate going around today is finding ways of improving performance of the sector through aggregation of several companies and creation of regions in order to benefit from economies of scale. This solution is supported by the Albanian Government not only for improving the efficiency of the sector, but also as opportunity to attract private investors in the form of public-private partnerships.

## 5. CONCLUSIONS

This study analyzed monitoring and comparative evaluation of the performance indicators of water supply and sewerage sector in general with a special focus in Albania. Decentralisation of water supply and sewerage services, monopolistic nature of water and the presence of many stakeholders in this sector make necessary data monitoring and evaluation of sector performance. There are many studies performed on water and sewerage sector, but few studies have focused on the efficiency of water supply and sewerage companies.

This observation stands in contrast when we consider the importance of the sector for the economic development and social welfare, and the relationship of this sector with other sectors such as health, agriculture and energy. This study analyzed 7 performance indicators most important for the financial situation of water supply and sewerage companies in Albania. The study revealed that the majority of water supply and sewerage companies are not able to cover operating costs and there many factors causing this situation: low rates, lower collection rate, high levels of non-revenue water and the overall poor efficiency.

The trend for the period 2006-2011 showed improved indicators and sector performance, but still the results are far from international standards. Because water supply and sewerage sector is important for the Albanian public policy it increases interest of having more in depth and comprehensive studies in the future. To this respect, benchmarking can help to address and evaluate possible solutions such as aggregating several

companies and creating regional companies to realize economies of scale. This will be important for the Albanian Government to guide the necessary investments needed in the sector.

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## **LABOUR MARKET REFORM IN THE BALKANS: A WAY OUT OF THE CRISIS?**

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### **ABSTRACT**

From 2000 until 2008, the transition economies of Central Eastern and South Eastern Europe (CEE and SEE) experienced large amounts of Foreign Direct Investment (FDI) from the West. Multinationals contributed to exports growth, but also to trade imbalance by forced imports or through the outflow of a large portion of their profits. Moreover, the ratio of credit to GDP doubled between 2001 and 2007, following a rapid expansion in consumption. Hungary was the first to reveal weakness, in a fall of growth rate from 4% in 2006 to less than 1% in 2007. In 2008, the downturn was sharpest where the growth had been most spectacular: in Estonia and Latvia with -5.1 and -4.2% growth rate, respectively. In 2009, all other Eastern European states (except Poland) were confronted with the most radical recessions throughout the EU – reflected in declining growth rates, from -4.2 in the Czech Republic to -18% in Lithuania. In the next phase, the IMF granted loans in order that such countries tackle the effects of the global financial crisis. After Hungary, Belarus, the Ukraine and Latvia in the CEE region, it was Serbia and then Romania in the SEE region to borrow money from the IMF. Bulgaria, also as vulnerable as but poorer than Romania, postponed such a deal due to a much smaller budget deficit. While Greece has been receiving financial support from the IMF since May 2010. The IMF loans were granted under conditional terms of austerity and structural adjustment policies that uniformly imposed: public expenditures cuts, reforms deregulating the economy (removing protections), flexibilisation of the labour market (abolishing labour rights protection) and mass privatization (of national assets). Those conditional policies of restructuring and greater flexibility promised more FDI-favourable conditions and thus, increased competitiveness and growth. So far however, the suppressed expenditures on welfare, pensions and public sector wages, along with the labour market deregulation has attacked the remaining forms of social protection and deepened poverty and unemployment in all IMF-loan recipient countries. As the SEE economies have not yet emerged from recession, the anticipated export-led recovery appears to be uneven and underlines the fragility of the EU. In this context, there is a growing debate concerning the effectiveness of the structural reforms imposed by the combined action of the IMF and the European institutions, especially in the weak periphery of Europe. We focus on the region of the Balkans as it forms part of the European ‘super-periphery’. It consists of transition economies of a significant EU-integration degree (as candidates or potential candidates for EU membership), as well as of the recent EU-member countries of Romania and Bulgaria and also Greece, which since 2001 belongs to the eurozone. We acknowledge the diverse historical and political paths of the countries in question and the different elements of the crisis they are going through today. But since they are all submitted to similar restructuring policies, we explore the impact of the recent labour market reforms on their economies as measures boosting growth.

### **KEYWORDS**

Recession, IMF, labour flexibilisation, FDI, employability

### **JEL CLASSIFICATION CODES**

R1, J5, P25

## **1. INTRODUCTION**

From 2000 until 2008, the European ‘super-periphery’ (Bartlett, 2009) – consisting of the transition economies of Central Eastern and South Eastern Europe (CEE and SEE) - experienced large amounts of Foreign Direct Investment (FDI) from the West. Multinationals transferred part of their production there due to low taxes and wages, imported semi-finished products, and exported to the Western markets. The outcome was a significant growth in exports, but also trade imbalance due to forced imports or outflows of their

profits. Moreover, the ratio of credit to GDP doubled between 2001 and 2007, following a rapid expansion in consumption. According to many theorists and analysts, unbalanced growth is in the core of crises - whether referring to the USA, Greece or the Baltic States.

Hungary was the first to reveal weakness, in a fall of growth rate from 4% in 2006 to less than 1% in 2007. In 2008, the downturn was sharpest where the growth had been most spectacular: in Estonia and Latvia with -5.1 and -4.2% growth rate, respectively. In 2009, all other Eastern European states (except Poland) were confronted with the most radical recessions throughout the EU – reflected in declining growth rates, from -4.2 in the Czech Republic to -18% in Lithuania. They turned then to the IMF for loans in order to tackle the effects of the global financial crisis. After Hungary, Belarus, the Ukraine and Latvia in the CEE region, it was Serbia and then Romania in the SEE region to borrow money from the IMF. Bulgaria - also as vulnerable as, but poorer than Romania - postponed such a deal due to a much smaller budget deficit. While Greece, has succumbed to financial support from the IMF since May 2010.

The recourse of the CE and SE European peripheries to the IMF reveals the fragility of the EU. The IMF loans were granted under conditional terms of austerity and structural adjustment policies that imposed uniformly to all recipient countries: public expenditures cuts, reforms deregulating the economy (removing protections), flexibilisation of the labour market (abolishing labour rights protection) and mass privatization of national assets (ranging from gas, water and electricity utilities to airports, state lotteries and postal services). Those conditional policies of restructuring and greater flexibility have promised more FDI-favourable conditions and thus, competitiveness and growth. So far however, the suppressed expenditures on welfare, pensions and public sector wages, along with the labour market deregulation has attacked the remaining forms of social protection and deepened poverty and unemployment in all IMF-loan recipient countries.

Although in the second quarter of 2009 real GDP showed a slight increase in most CEE countries, the SEE economies have not yet emerged from recession. In other words, the anticipated export-led recovery appears to be uneven and underlines the ‘peripherality’ of the respective regions. We focus on the region of the Balkans, which forms part of the European ‘super-periphery’. This set of countries includes EU eastern neighbourhood states that are not EU members, although all of them have achieved significant degree of EU integration and most are candidates or potential candidates for EU membership. The recent EU-member countries of Romania and Bulgaria are also included; and Greece, a eurozone member since 2001. Despite the diverse historical and political paths of the region’s countries and the different elements of the crisis they are going through today, we acknowledge many common areas between them.

All countries in question have historically been ranked at the lower positions in Europe’s scale of wealth, despite their relatively high growth rates in the last decades. According to data, the eurozone crisis has hit the Balkan countries extremely hard with record falls in GDP growth rates compared to the rest of Europe, combined with extremely high and increasing unemployment levels. The IMF is asking loan-recipient countries in the region (as in CEE, too) to adopt measures that lead their economies to contract. This is however, exactly the opposite of the policies carried out by rich countries and supported by the IMF, for rich countries only (Balaceanu, Apostol, Penu, 2012). There is consequently a growing debate over the effectiveness of austerity and the structural reforms imposed by the combined action of the IMF and the European institutions, especially in the weak Balkan region. In this context, we specifically underline the impact of the implemented labour market reforms as measures to boost growth.

## **2. THE PERIPHERAL FACETS OF THE EUROZONE CRISIS**

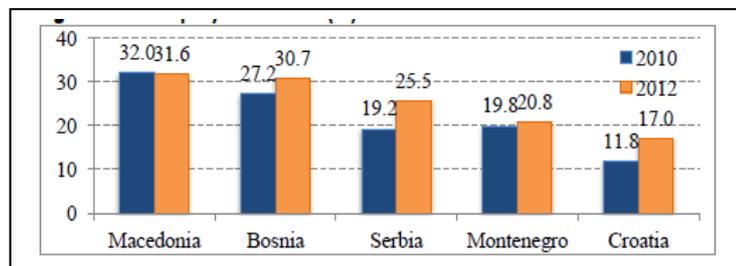
As the ‘centre-periphery divide’ has become a major feature of the crisis, it questions the institutional configuration of the eurozone and the prevailing form of the EU integration. Greece, along with the other weak EU members, was severely damaged by the eurozone crisis; but it’s been argued that the effect had been even more damaging for the country’s Balkan neighbours outside the eurozone. In several of these countries (Bosnia, FYROM, and Serbia), unemployment currently exceeds 25% – a percentage even worse than in Greece or Spain. The ‘euroization’ (Bartlett & Prica, 2013), particularly strong in the Balkan economies, has made these countries of the ‘super-periphery’ especially vulnerable. In Serbia, for example, more than 80% of all private sector loans are denominated in a foreign currency (Brown & De Haas, 2012); while in Montenegro the euro is officially legal tender.

The Southern European eurozone member-countries were not immediately hit by shortage of capital inflows. The impact of declining exports on their economic performance was less pronounced than in the more export-orientated countries. It was at the beginning of 2010, when Southern European countries were heavily affected via the credit channel. Starting with Greece, all Mediterranean countries got under increasing pressure from financial capital. Greece was particularly vulnerable due to high levels of public debt and the manipulation of official deficit figures. This was taken as a starting point for a degradation of rating and increasing spreads. Notably, all three economies of the European South - Portugal, Spain and Greece – were structurally dependent on capital inflows and vulnerable to speculative attacks. (Becker & Jäger, 2011).

The social-democratic governments of the peripheral eurozone countries of Southern Europe were confronted with increasing credit costs and strong pressure by banks, by the European Commission, and by governments of the EU-core to implement neoliberal austerity policies. Such policies would accelerate the re-regulation which was initiated in the 1980s by labour market ‘flexibilisation’, monetary policy and the liberalisation of the financial market (Becker & Jäger, 2011). This practice however had a high risk of exacerbating pre-existing structural problems and disintegrative tendencies (Cafruny & Ryner, 2006). As a matter of fact, it led to drastic internal demand reduction and deepening recession. Greece faced the strongest economic decline in Europe in 2010, with a growth rate of -4.2% (Eurostat, 2011).

On the other hand, the ‘euroization’ of the Balkan countries outside the eurozone impedes real devaluation, thus internal devaluation through domestic recession and reduction of unit labour costs is the way followed to restore international competitiveness. These countries are doing so without the EU support for debt reduction and consequently they have imposed even harsher austerity programs than those attempted in Greece (Bartlett & Prica, 2013). Moreover, the increased unemployment rates in the Balkan countries are even worse than in the peripheral EU countries which were worst affected by the eurozone crisis. In Greece the unemployment rate reached 22.5% in April 2012, at the same time that the unemployment rate in the eurozone reached 11.2%. This percentage was however exceeded in Bosnia and Herzegovina (30.7%), Macedonia (31.6%), and Serbia (25.5%), providing further evidence of the position of the Balkan countries in the European ‘super-periphery’.

Figure 1. Unemployment rates (%) in Western Balkans, 2010 and 2012

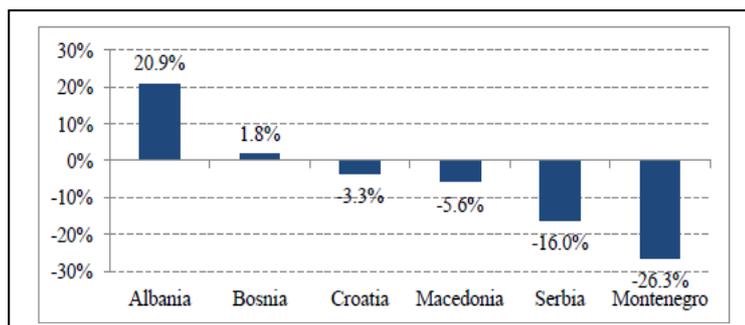


Source: National Statistical Offices, Labour Force Survey data

Youth unemployment has increased to even more dramatic levels. The unemployment rate of people of 15-24 years of age in Bosnia and Herzegovina was 57.9% in 2011, 40.4% in q1-2012 in Montenegro and 45.2% in q1-2012 in Croatia. In Serbia, the unemployment rate of people of 20-24 years of age was 48.8% in 2011. In comparison, youth unemployment in the eurozone for people under 25 years old was 22.4% in the same period. The situation however reached peak levels in Greece and Spain, where in June 2012 youth unemployment reached 51.5% and 52.7% respectively - even higher than in the Balkan countries (with the exception of Bosnia and Herzegovina). (National Statistical Offices, Labour Force Survey data, 2010-2011)

In terms of competitiveness, exports to the eurozone fell in most economies of the region between the first quarter of 2011 and the first quarter of 2012. The most affected countries have been Montenegro and Serbia, with losses of -26% and -16% respectively over that period. Albania has been the exception, because of its very small exports and thus, low base effects. (IMF - DOTS, 2012)

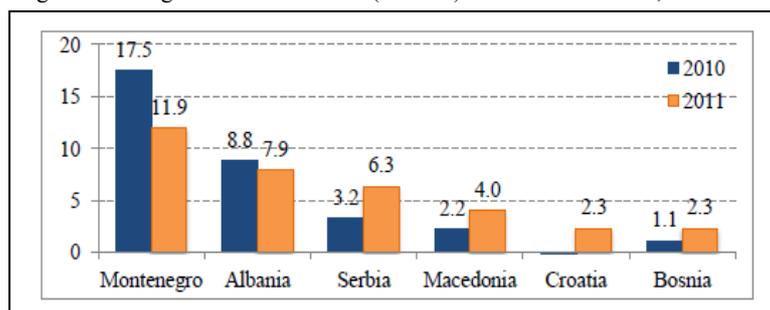
Figure 2. Exports to the Euro Area (% change, 2012q1/2011q1, Euros)



Source: IMF Direction of Trade Statistics (DOTS), adjusted for end of quarter of exchange rates

The collapse of international capital flows, as a consequence of the 2008 global financial crisis, was reflected in a sharp reduction of FDI inflows to the Balkans (Prica & Uvalić, 2009; Bartlett & Monastiriotis 2010; Bartlett & Prica, 2011). FDI continued decreasing in Albania and Montenegro, while other countries that had been hit harder by the initial shock saw some FDI recovery in relation to GDP between 2010 and 2011. Still, the FDI levels across all countries in the region are far lower than in the pre-crisis period. (European Commission, 2012)

Figure 3. Foreign Direct Investment (% GDP) in Western Balkans, 2010 and 2011



Source: Candidate and Pre-Accession Countries' Economic Quarterly, 2012 q2, European Commission ECFIN Unit D-1, 6<sup>th</sup> July 2012

An IMF/EU program was applied to Greece in 2010 and was tightened in 2011. Ireland and Portugal followed in 2010 and 2011. The immediate debt reduction was estimated to reach €26bn, i.e. 12% of the Greek GDP. But still, the underlying structural problems of the peripheral Greek economy were not addressed and the debt problems have only been postponed (Becker, 2011). The austerity measures which are contained in the program for Greece (Ireland and Portugal as well) particularly focus on wage reductions, public expenditure cuts and flexibilisation of the wage relation. In addition, the EC and the IMF press for an extended privatisation program (both in Greece and Portugal) of state-run industries, as a way to improve competitiveness and attract FDI in the eurozone (IMF, 2010; 2011a; 2011b; 2012; 2012a; 2012b).

Romania has joined Eastern European countries for emergency aid from the IMF, securing €20bn to cover a torrent of foreign debts in the end of 2008 and 2009. The rescue package includes €5bn from the EU's bail-out fund, project aid from the World Bank and the European Bank for Reconstruction and Development. It aims to smooth the downturn as the economy struggles with collapsing steel prices and falling demand for car exports. In order to receive the IMF loans, Romania agreed to austere conditions concerning both performance criteria and structural benchmarks (Constantin, Goschin, Danciu, 2011). Public wage bill has to be reduced from 9% of GDP in 2009 (increasing from 4.8% of GDP in 2004) to 7% of GDP by 2015. Public sector wages are cut by 25% starting from July 2010, while pensions are frozen. The labour market and industrial relations were at the core of the structural reforms. In addition, high interest rates, regressive tax

increases, currency devaluation and other measures are making the country even poorer within the EU. (Balaceanu, Apostol, Penu, 2012).

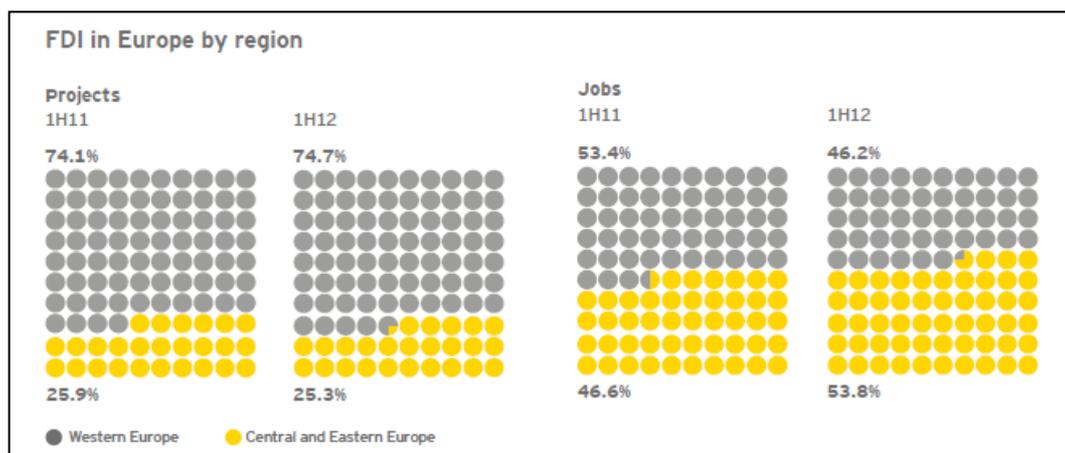
### 3. LABOUR MARKET REFORM AS A WAY OUT

Many countries over the last couple of years of the financial crisis have introduced far-reaching reforms of their wage setting systems in the direction of higher wage responsiveness to economic conditions at local level. As previously indicated, major reforms were passed also as part of the reform packages agreed under the financial assistance programs in Greece, Ireland, Portugal and Romania. Measures taken towards the ‘decentralisation’ of collective bargaining were adopted in Romania, Greece, Spain and Italy. A cut down on the extension of expired and not renewed contracts was decided in Spain and Greece. The minimum wage was cut in Greece, frozen in Czech Republic, Latvia, Portugal and Ireland. These measures were adopted on the assumption that ‘decentralisation’ would allow for wages that better reflect productivity at the local level and help unemployment absorption.

According to recent data, in the post-crisis period of 2008-2012 (ILO, 2012): 40 countries out of 131 have altered their employment protection regulations for permanent employees mainly by modifying the regulation of severance payments and notice periods; among advanced economies, 76% of the reforms have ‘relaxed’ employment protection regulations for permanent employees; 15 countries have modified their legislation by reducing the requirements for collective dismissals - particularly, in Central and South Eastern Europe. Undoubtedly, reforms promoting softer employment protection regulations and decentralized collective bargaining have been accelerated. (Gialis & Tsampra, 2012)

A review of over 100 studies (ILO, 2012) shows that reforms of employment regulations and collective bargaining have had diverse labour market impacts. Some of them have reduced job stability and exacerbate inequalities, while failing to boost employment levels. In recession countries specifically, the weakening of regulations and institutions has left the labour market with no protection floor or a very low one – thereby hampering job recovery prospects. Nevertheless, EU experts still consider South European labour markets – such as those of Greece, Italy and Portugal - to be highly inflexible due to employment ‘protectionism’ (EC, 2011). In the same line, reports from the respective Ministries of Labour consider the ‘limited availability’ of atypical employment and the protection against dismissals, as main causes of labour market rigidity and persisting unemployment in their countries (EC, 2011).

Figure 4. Foreign Direct Investment in Europe by Region



Source: Ernst & Young’s European Investment Monitor 2012 (interim)

Many of Europe's difficulties today are attributed to the persisting disparities in competitiveness between its Northern and Southern regions, especially concerning labour productivity and flexibility. Despite the global downturn and uncertainties due to the ongoing eurozone crisis, Europe still continues to attract FDI. Western Europe has been the second most attractive FDI destination, while Central and Eastern Europe has been the third. In the first half of 2012, foreign companies made more than 1,500 investment decisions in Europe, an increase of 6.3% on the first six months of 2011. The 78,299 jobs created by FDI in the first half of 2012 partially compensate for job losses due to restructuring and supply chain squeezes across many industries. (Ernst & Young, 2012)

As depicted for 2011 and 2012, Western European countries are attracting more projects than their Central and Eastern European neighbours, while for the latter there is a benefit in terms of jobs (Ernst & Young, 2012). In other words, no advantageous situation for FDI is observed in CEE, despite the increased labour market flexibilisation of the last years. It should be also acknowledged that the impact of FDI on host economies and firms depend on a wide range of factors, e.g. the type of investment, the absorptive capacity of the host country, the size and other characteristics of firms. It is therefore crucial to maximize FDI benefits for local firms and minimize any potential adverse effects.

### 3.1 Romania

In the last quarter of 2008 Romania's economy took a sudden turn for the worse; industrial production and domestic consumption rapidly declined and budget revenues collapsed (Stoiciu, 2012). The economic downturn was further deepened by a severe FDI drop of -48.4% in 2009, compared to the record levels of 2007 and 2008. Private investments are shrinking and no fiscal stimulus is provided, but Romania still remains attractive to foreign investors (16th, according to A.T. Kearney's global ranking<sup>1</sup>) largely because the crisis reduced the wage expectations of Romania's skilled, polyglot and adaptable labour force. Even before the crisis and also before Romania's accession to the EU in January 2007, the private sector has put increasing pressure on wages as a way to accelerate convergence with the EU and stimulate private consumption (Constantin, Goschin, Danciu, 2011).

Until the financial crisis broke in, the Romanian labour market had performed relatively well. Annual unemployment rate had declined to 4.1% in 2007 and 4.4% in 2008, supported by high rates of GDP growth over the years 2000-2008 and a decrease in the labour force owing to substantial out-migration (as estimated, over two million Romanians work abroad). The main problems in the labour market prior to the crisis were: (i) low employment rates (from 61% in 2000, to 59% in 2008 and almost recovered to 60.1% in 2010); (ii) persisting long term unemployment; (iii) young people unemployment; (iv) extended employment in the underground economy; (v) high emigration and self-employment in subsistence agriculture.

The crisis aggravated all these structural labour market problems: increasing unemployment, high underground economy and fiscal burden, and decreasing remittances. The scaling down of production capacities amid the economic crisis led to severe labour market adjustments: (i) massive layoffs in industry and construction and (ii) significant unemployment increase (which reached a rate of 7.8 % in 2009, but decreased to 6.87% in the end of 2010). The growing unemployment has deepened social inequalities and triggered re-migration (from big cities to towns and villages and also, migrants return from abroad). (Constantin, Goschin, Danciu, 2011).

Labour market adjustments were initially made by the private sector. The new Labour Code passed in March 2011, despite disapproval by the trade unions, employers' associations and the parliamentary opposition. The new law regulated relations in the labour market, allowing easier termination of employment, as well as the use of fixed-term employment contracts and temporary work (Stoiciu, 2012). As a result, layoffs in industry, construction and commerce totaled around 315,000 employees by the end of 2009 – which was over 85% of the total redundancies in the economy.

Overall, the number of redundancies contracted by 13%, from the peak of 4.8 million in May 2008 reaching 4.2 million in June 2011. At the same time, the government engaged in a process of restructuring public sector employment, as well. According to Eurofund data in 2010, the peak year of austerity, Romania was the EU champion in job restructuring with 78,700 jobs terminated - representing 21% of the total jobs

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<sup>1</sup> A.T. Kearney is a global management consulting firm, focusing on strategic and operational CEO-agenda issues for the world's leading organizations across all major industries and sectors. It was founded in 1926 and its head office has remained ever since in Chicago, Illinois

losses in all EU countries. The terminated government positions (60,610 jobs) in Romania represent 54.64% of the total government positions eliminated in the entire EU (Stoiciu, 2012).

Another significant regulatory change introduced in 2011 concerned the reform of the social security system, as it intended to diminish the ‘extensive’ welfare state and ‘encourage employment’ by reducing welfare payments. The main changes enacted by the new law consisted of stricter tests for resources, defining the level of welfare benefits by the social reference indicator (instead of the minimum wage, as before) and transferring the financial burden to the local government authorities by creating the social security fund, 30% of which was made up of money granted from the state budget and 70% of local budget. The result was the widening of the gap between the poorer and richer areas of Romania.

Structural reforms also included the health care system. The cost cuts resulted into shutting down 67 state hospitals in 2011. A draft bill aiming to radically change the health care system was put up for public debate at the beginning of 2012: health care insurance was to be managed by private companies, ‘as in the Netherlands’, while the public hospitals were either to be turned into foundations or privatized. Due to major public disapproval and street protests the draft bill was abandoned, but the reform plan was maintained and a new draft health care bill - very similar to the previous one - was tabled for public debate in June 2012. (Stoiciu, 2012)

The reform of the labour market was essential, considering that Romania has one of the lowest employment rates in Europe and labour migration is a massive phenomenon, affecting about one-third of the total active population. However, the authorities focused on increasing the flexibility of the labour market, as a necessary adjustment for a more competitive economy, although the assessment reports of Romania’s competitiveness (Schwab, 2010) did not point out any rigidity of industrial relations (but instead, bureaucracy, state corruption, inadequate infrastructure etc, as the major problems). Despite the necessity for reforms, many measures in the social field diminish the welfare state through various actions that cannot be justified by any objective or constraint. Such measures are based on the assumption that the country’s welfare state was oversized and that social expenditure was responsible for the economic crisis. However, according to Eurostat, Romania’s social welfare costs do not exceed 15% of GDP - one of the lowest levels in the EU. The same applies to the share of such costs in the state budget. According to Stoiciu (2012), the role of private-sector stakeholders in the formation of certain labour relations measures was essential: i.e. the Council of Foreign Investors and the American Chamber of Commerce.

Considering the short time that has passed, it is difficult to accurately quantify the effects of the austerity measures and structural reforms on the Romanian economy. After two years of negative values, in 2011 domestic demand increased by 3.2% and the economy grew by 2.5%. The population’s real purchasing power showed an increase in the beginning of 2012, due to a slight rise in salaries and to the modest revival of lending. Nevertheless, the labour market is still negatively affected by the crisis: unemployment reached 7.4% at the end of 2011, higher than immediately before the crisis; while the number of active employees saw only an insignificant increase. Moreover, the instability and poverty risk associated with temporary and part-time employment have grown. According to Eurostat, in 2010 the rate of part-time employees at risk of poverty was 50.7% - over than three times higher than for full-time employees (15.1%). In 2010, the percentage of people at risk of poverty was 45.4 for the unemployed and 29.8 for the inactive, compared to the national average of 21.4%.

### **3.2 Greece**

Along with Ireland, Portugal and Spain, Greece is a country whose responsiveness to ‘Going for Growth’ recommendations (OECD, 2012) increased the most between 2008-2009 and 2010-2011. The conditional terms of the IMF/EU financial help forced the country to enact unpopular reforms, mainly in its labour market regulations and social welfare system (e.g. wages, pension and social security). However, as it often appears, countries that proceed with the largest reductions in real wage growth, experience the largest declines in labour productivity growth (Naastepad, 2003). In Greece, the 2009 crisis which further marginalized the country’s economic status by magnifying public deficit, hit both small entrepreneurship and overall waged employment as well as the socially embedded forms of atypical employment.

Low employment and the shrinking income share of wages is accompanied by impressively long working hours – largely attributed to the self-employed workers (Mitsopoulos & Pelagidis, 2009). This suggests the market’s attempt to downsize employment, especially salaried, and at the same time stretch to the limit the

use of the labour force. The structural weaknesses of the Greek labour market, such as segmentation (i.e. unequal working conditions and opportunities for the labour force) and low levels of labour mobility, along with poor social security regulation, have been aggravated under these conditions.

Labour flexibilisation in Greece is not new phenomenon. The country's labour market has for long been regulated by a degree of flexibility higher than the EU average - especially in terms of job security, working time and social benefits. Evidently, despite existing rigidities, flexibilisation has been accelerated since the late 1990s and reached a peak since 2009. The recent austerity and bailout packages implemented by the Greek governments and the IMF/EU further dismantle the country's labour market, abolish any remaining labour protection, and exacerbate unemployment and poverty. The structural and legislative reforms that take place have reduced real wage, but have not hampered rising unemployment nor boosted employment. On the contrary, the deregulation of labour relations has abolished collective wages agreements and deprived employees from elementary job protection rights.

A tremendous increase of unemployment, part-time and temporary employment is currently taking place (i.e. unemployment accounting for 8% and part-time employment for 6.8% at the end of 2011). Employment data clearly reflect the impact of the recession in the Greek labour market, since the beginning of 2009. But the identified trends were initialized even before, as total employment in 2009 decreased comparatively to 2008, and the most injured group was that of male regular employees in the age of 25-44 years. Overall, in 2005-2009 both total employment and atypical employment increased (+3.1% and +2.5% respectively), while unemployment of women and the young, remained stable. From 2009 to 2011 the overall labour market situation has dramatically worsened: both total employment and typical waged employees have fallen at about 10%; unemployment has risen to 17.7% and total atypical employment has also fallen (-6.5%). (Gialis & Tsampra, 2012) In terms of production, data show the bigger job losses in manufacturing and construction. Tourism was also hurt, as well as financial and insurance activities, professional and scientific services (INE, 2011).

The low unemployment compensation rate, the absence of safety net after the insurance benefit runs out and the very short period of benefit entitlement for young people, unemployed women and first-time job seekers, are elements of the Greek social security system which don't justify the EU reasoning that detachment from welfare benefits will trigger labour market demand. Promoted measures intensify labour flexibility but do not achieve respectively social security. In fact, almost 60% of part-time workers in Greece are seeking for a typical, full-time job. Employers on the other hand, prefer temporary employment to regular, with contracts of 4-12 months for 55%, 13-18 months for 11% and more than 36 months for just 13% of the employees (INE, 2012).

In a very recent paper, Gavroglou (2012) documents, with data from Eurostat's Labour Cost Index, the evolution of hourly labour costs in Greece before and after the IMF/EU Memorandum and the imposition of austerity policies. According to his analysis, between the first quarter of 2010 and the third quarter of 2011 total labour costs in the economy decreased by 14.3% in nominal terms. Non-wage labour costs tended to decrease faster than total wage costs in almost all sectors. Compared to most other countries, total labour costs in Greece increased at a significantly faster rate during the previous decade. Between the first quarter of 2000 and 2010 nominal labour costs increased by 54.1% in Greece - against an increase of 28.7% in Portugal and 18.6% in Germany. Nevertheless, labour costs in Portugal remained stable and increased by 2.8% in Germany, when they fell by 14.3% in Greece.

In short, the EC/IMF program has deepened recession in the country so far: Greece faced the deepest GDP decline of all EU countries in 2010 (Eurostat, 2011). The prolonged recession has affected the budget negatively; as the EC (2011) admits, tax revenues remained behind expectations; the public debt/GDP ratio continued to grow strongly in 2010 - given weak tax revenues and a falling GDP; and these trends have continued in 2011 and 2012. This policy was justified by two types of arguments: 'ideological' and 'technical'. The 'ideological' justification included the attack on the social 'interventionist' and 'extortionate' welfare state. The 'technical' justification referred to the requirements of the IMF, the EU and an almost unanimously acknowledged need for reforming some key sectors of the economy and society.

Undoubtedly, most of the sectors affected by the austerity measures needed structural reform: improved transparency, clearly defined principles and rules for fiscal policy, etc. However, most of the reforms aimed at diminishing the welfare state and limiting social rights, while breaching multiple provisions of the ILO conventions. The change of the wage relation is at the very heart of the EC/IMF programs. In this way, a partial shift of the wage relation to European level has been implemented: while until the crisis the wage relation had been the only structural form still mainly organized at the level of the nation state, this has

changed during the crisis. Wage policies and social spending, being part of the wage relation, are now regulated to an important extent at EU level for the peripheral countries in and out of the eurozone (Becker & Jäger, 2011).

#### 4. CONCLUSION

The divide between the core and the periphery of the European Union has deepened by the eurozone crisis and the measures adopted. The Balkan region of the EU ‘super-periphery’ was hit extremely hard, with record falls in GDP growth rates compared to the rest of Europe, combined with extremely high and increasing unemployment levels. Furthermore, their prospects of recovery are still dim. In spite of their failures, the programs imposed by the IMF/EU are being institutionalised throughout CE and SE Europe. Disintegrative processes pushed by neo-mercantilist countries tend to become stronger, while moderate alternative policies have been marginalised so far. What are the possible ways out? By focusing on promoted labour market reforms, especially in Romania and Greece, we indicated the deregulation of employment relations and the welfare state.

Structural and legislative reforms implemented since 2009 have not hampered rising unemployment or boosted employment, and neither enhanced FDI. On the contrary, increasing labour flexibility has deprived employees from elementary job protection and security, and acutely devaluated their work. Post-crisis trends and their impact on labour markets indicate that recent changes in employment regulations may be counter-productive not only in terms of employment levels, but also in terms of private-sector investment. In other words, austerity measures and structural reforms have so far achieved increasing precariousness and social insecurity in the respective economies, as well as deepened the crisis and widened the gap between the EU core and its periphery. The policy debate should therefore focus on the efficient design of regulations and institutions, rather than on ‘less regulation versus more regulation’.

In the Balkans, the high degree of EU integration (e.g. regional trade agreements) and euroization have increased the vulnerability and weaknesses of the region’s countries. Intra-regional cooperation could be an alternative to the over-dependence of the region on the EU (Sklias & Tsampra, 2013). Despite existing political obstacles to such cooperation, the benefits justify the effort to overcome them. Regional business potential could be enhanced by regional infrastructure investments, by the creation of a regional labour market, by shared research capacities and integrated educational and training capacities (Bartlett & Prica, 2013). The capitalization of the region’s considerable resources could achieve economies of scale and promote externalities that boost economic growth at the regional level. Hence, related policies should explicitly consider pre-established structures and legacies of production and employment in national and local labour markets (Gialis & Tsampra, 2012).

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# THE EUROPEAN DEBT CRISIS: UNIFICATION OR THE BALKANIZATION OF THE EU

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## ABSTRACT

In 2008 the debt crisis that erupted in the U.S. caused turbulence in the global economy, particularly in the European economy. Main victims in the European Union were the countries with either their banking system was exposed to toxic derivatives of U.S. banks see Ireland or economies had structural problems as in the case of Greece. This resulted that the debt crisis gradually spread to other countries in the EU's main core so the debt crisis become a dominant issue for the Union, mainly for the countries of the Euro zone. This situation has exposed the inherent weaknesses which presents the European Union and especially the processes of European integration mainly the institutional deficit which is presented in this resetting the question which posed by many scholars over the years, "What is the EU, another State or an international organizations?". The institutional deficit in the integration processes became highly visible in several EU summit meetings which organized to address the problems of member countries and their rescue when it became apparent that the lack of the necessary structures to deal with such situations and the approach the problem of the member countries which have essentially divided into lenders and borrowers or as otherwise described as north and south making it unstable the European architecture. With the present study attempt to approach the European construction through the perspective of dealing with the debt crisis of the Eurozone sovereign question whether this crisis will be the springboard for European integration or the Balkanization of the EU with the term Balkanization pose the idea of dissolution.

## KEYWORDS

Debt Crisis, Economic and Political Governance, EU

## JEL CLASSIFICATION CODES

P16, F55, F59

## 1. INTRODUCTION

Even though there are competitive organizational principles between globalization and regionalization with regard to the field of international relations, in fact the former complements the latter (Tsardanidis 2005). For this reason, it can be argued that globalization has facilitated the emergence of a multilayered system of global governance which is based on regional organizations. On the other hand, the process of marginalization constitutes the nation state's response to the challenges resulting from globalization. In particular, the small states and middle powers take part in various marginalization structures searching for pooled sovereignty and resources.

However, this process of pooled sovereignty creates the preconditions required to overcome the nation-state concept through the creation of new supranational entities of decision making and policy implementation by, thus, introducing a new regulatory attitude towards structures – manners of intergovernmental co-operation. At the same time, the process of gathering resources is a milder approach to the process of creating supranational structures within the context of regional cooperation.

In most cases, the liberalization of trade and the free movement of capital is at the core of most regional cooperation structures, since it is believed that larger markets will create economies of scale that will enhance the attractiveness and competitiveness of a region for investors while, along with the increasing pressures on local companies, they will lead to their improved productivity and competitiveness by facilitating, in this way, their adaptation to the demands of the global market.

The EC and then the EU initially constituted the first line of defense with regard to regionalization in the neoliberal models of globalization that were upheld by the U.S. and the international institutions dominated by Washington. Economic globalization has facilitated both the deepening and the widening of the European Enlargement, as declared through the single European Act and the Maastricht Treaty, the Common Market and the European economic and monetary union.

## **2. THE EU AS A SYSTEM OF MULTILEVEL GOVERNANCE**

In the decade following the end of the Cold War, the rebirth of regionalism was witnessed. This rebirth created the New regionalism. The New regionalism places emphasis on the sustainability of the region within the multi-polar world order which is created by the perpetual action of states and non-state agents. The new regionalism has constituted an attractive proposal for numerous former communist countries for two main reasons. The first reason is that regional economic agreements could attract foreign investment and the second one is that it was considered that regional relationships may lead to gradual liberalization, which these countries needed. The principal exponent of New regionalism is the EU which exhibits many of the features of new regionalism, as described by Tsardanidis, that is:

- Mega-regionalism, in which a large number of states gets involved in the financial agreements. Today EU comprises 27 countries.
- The major political and economic forces which boost regionalism. The role of Germany and France as well as other non-state agents in the operation of the EU is widely known.
- Regionalisation includes developed and under transition countries, large and small ones and aims at ensuring investment of developed countries in under transition ones. The EU27 comprises not only large and powerful countries but countries that are or used to be under transition as well.
- There is a great variety of institutionalism as many countries coalesce, avoiding the institutional and bureaucratic structures of traditional international institutions.
- The new regionalism is multidimensional since it is very hard to draw lines between economic and political regionalization.
- The new regionalism is bottom-up as collaborations are imposed by a large number of institutions, business elites, organizations and movements.
- Unlike the classic regionalism, the new one is characterized by the participation of one agent in several regional partnerships.
- The multiple levels of regionalization. In the EU there are Member States of the euro area and non-member states of the Euro zone.

For this new form of regionalism, the question arises whether this process is an opponent of globalization or an additional piece of globalization; that is, if the former is the financial expression and the latter the political expression of the same process of global structural change. Without wishing to avoid answering this question, it will have to be concluded that both of them have been hitherto operating complementarily, especially in the case of the EU, since its Member States participate in all organizations controlled by Washington, creating, thus, a more coherent system of multilevel operation within their framework of operation. At the same time, this process creates another issue, ie the determination of the main agents in this process. Are these the economic forces, or are they the forces coming from the civil society and what is the relationship connecting countries, the market or the civil society? (Tsardanidis 2005)

In the framework formed, a constant scientific question emerges about the uniqueness of the EU, not holistically but with regard to the consideration which would explain its aspects. That is to say, which general theory could explain it, the International Relations or the Comparative Politics one?

Those who support the perspective of International Relations argue that the EU is not a state but a creation of dependent States (Hoffmann 1966; Moravcsik 1998; Haas 2004). On the contrary, for the supporters of Comparative Policy the EU is such a non-typical International Organization that all theories of international relations are inapplicable (Lindberg 1970; Hix 2005). However, it is worth noting that both theoretical approaches have significantly contributed to a better understanding of the EU, since even when one exhibits gaps, these are covered by the other.

Through the perspective of International Relations, the EU is regarded as a highly institutionalized system of negotiation among states in contrast to the Comparative Policy approach which holds that policy making

and politics in the EU are exerted by a few agents as there are constant safety dilemmas in an anarchic environment, which resembles the ordinary exercise of policy in western democracies (Jachtenfuchs 2005).

### **3. THE THEORETICAL APPROACH OF THE EUROPEAN INTEGRATION**

New perspectives on an issue are often developed because of an inability to explain the issues of concern to researchers who do not contradict the prevailing theories through testing, but they just ignore them and start something new without initially offering great new theories. This was the case regarding the studies on European integration in the 1970s. The passionate debate of the 1960s about whether the European integration could best be explained through autonomous state agents (intergovernmentalism) or through social processes (neofunctionalism) had been outdated as the Euro policy and the importance it attached to International Relations became less interesting for the majority of the scholars and its position was taken by the current policies which seemed to be a more promising area of research (Puchala 1972; Haas 1975; Jachtenfuchs 2001). The change of a large part of studies on European integration made by the agents in their policies was symbolized by the publication of the first edition of 'Policy-making in the European Community' (Wallace 1977). Most studies initially focused on Community level only. Puchala (1984), who was a notable exception, argued that the course of the EC could be sufficiently understood only if the debate on the European state were made through the study of the international and the interior space of the EC simultaneously (Jachtenfuchs 2005).

A symbolic point of reference with regard to the beginning of a multilevel perspective in the studies on the EU was Fritz Scharpf's study 'Joint-Decision Trap' who started from the observation that the process of European integration lies in a stage characterized 'by frustration without disintegration and resilience without progress' (Scharpf 1988). This situation, according to Scharpf, was the systemic effect of a particular institutional combination between the European level of governance and the level of the Member States, which leads to the joint decision-making trap, especially when European interests conflict with the Member States interests.

As there are many common features between the European Federal system and the German one, many studies on the system of multilevel governance in the EU were presented by German researchers (Benz 2000; Scharpf 2001; Jachtenfuchs 2003; Kohler-Koch 2003). These studies easily accepted the system of multilevel governance in the EU and Germany's participation in a larger system of multilevel governance as the perceptions of living in Germany led to the eager acceptance of the European system of governance as well as its approach through the theories of Comparative policy.

Unlike German scholars, the EU and some Americans who lived in a superpower thought that the EU is controlled by three large countries (UK, France, Germany) just as the international institutions and for this reason their approaches were mostly conditioned by the theories of International Relations. But the U.S. is not only a superpower, it is also a federal system whose levels of governance are clearly more defined than in Germany or the EU. Therefore, the Americans were early to attempt to approach the EU as a multilevel or federal governance model, comparing it to their own federal model.

### **4. WHICH IS THE IMAGE OF THE EU**

If we examine the EU as a political system, we could be allowed to avoid the debate on whether the EU is or could become a state, although the discussion about a political system would be meaningful only when the political system identified with the concept of the state.

However, it should be noted that the EU closely resembles a potential federal state since there is no meeting of any intergovernmental body; then, indeed its analysis could be made through comparative politics. But this fact should not make us forget that the EU is not a state and that it differs greatly from federal states such as the USA.

At this point it is advisable to look at the features of the EU:

- No monopoly of power, no monopoly of taxation

Despite the impressive developments in the field of justice and internal affairs as well as in foreign and security policy, especially since the early '90s, the European Union does not control an army nor a police

force. Instead, the army and the police remain under the exclusive control of the Member States. Member States have the final say on the use of the instruments of power (Wagner 2003). In fact, the Member States' monopoly of power is increasingly being integrated through institutional regulations within the political system of the EU (Jachtenfuchs 2005). At the same time, there is no sign of an emerging competition for the monopoly of power between the central EU institutions and its Member States, and this is a key difference between the political system of the EU and the federal states. The latter usually gain control over the military forces whereas they also hold either their own police forces or at least exert constitutional control over the police forces in the lower levels of power (Bayley 1985).

Besides the monopoly of power, the second resource that the modern state has successfully managed to control during its development is the control of taxation. Consequently, the states have enormous financial resources at their disposal. As the monopoly of power, monopoly of taxation is under pressure by both globalization and Europeanization (Genschel 2005), but it still continues to exist. The financial resources that are available in the EU are much lower than the ones of the Member States and to a large extent they consist of contributions by Member States. Consequently, the EU itself has limited financial resources available for the exertion of economic policy. This has become particularly evident in recent years through the debt crisis which is affecting some member states since the implementation of rescue policies for these states do not pass through the exertion of the economic policies of the International Institutions of the EU but through its Intergovernmental Institutions, as the states possess the financial resources necessary to exercise political rescue.

- A hierarchical law system

While the EU does not hold a monopoly of power and taxation, it has a hierarchical law system which could briefly be described as a direct effect and primacy system over the law of its Member States (Weiler 1999). This is because the EU Treaties and secondary legislation create conditional direct individual rights and liabilities without having to be adopted by national legislations, while the European Union laws are superior and prevail over national ones, including the Constitution of the country. Consequently, the structure of the EU law system may to some extent balance the lack of a monopoly of power. Due to the direct effect doctrine, the rules of the EU may generate individual legal rights which, even not in effect, can be claimed by the courts of the Member States. In this way, decision-making and its implementation is carried out under the shadow of a legal hierarchy. Although European law is not yet similar to the domestic law of the Member States and it has not been fully integrated into this, it nonetheless seems to have a significantly higher legal effect over international law. (Zürn 1999)

- The weak political parties

In Western democracies, political parties constitute one of the intermediate institutions between citizens and governments, undoubtedly becoming the most important one since they create a rather direct link between the individual political preferences of citizens and the political choices of governments.

The development of the European Parliament within the EU has stimulated the organization and cohesion of political parties at an EU level. The first party structures at a European level arose on the occasion of the first direct elections for the European Parliament in 1979, which had exhibited limited programmatic and organizational cohesion despite the high expectations that had grown to the contrary (Reif et Al, 1980). However, their organizational structures, their programmatic coherence and their uniform attitude in polls have substantially risen since then (Gabel 2002; Hix 2005). However, the positions of the members of their parliamentary groups reflects the positions of the national parties from which they come from, rather than the positions held at a European level, and this occurs for several reasons. Firstly, because the European elections in many Member States are still minor compared to the national ones and are not concerned about choices on European issues but about national political issues instead (Reif and Schmitt, 1980). A second factor is the high ethnic segregation despite the institutional regulations at a European level (Jachtenfuchs 2002). Last but not least comes the fact that legislative power is being shared between the European Parliament and other EU institutions.

The European Parliament as a body in which the policies of parties are implemented in the European Union is a new institution in the legislative system and the operation of the EU. At the same time, although there are signs of a slow detachment from the early technocratic image towards a more political one, the European Commission is not constituted through elections and for this reason it does not present strong ideological cohesion. The same goes for the European Council, whose political composition is constantly changing as a result of different national elections. Consequently, the European Council does not follow the model of a conventional government but instead is a negotiation system with a limited role for the European

political parties and a very strong role for national governments and their institutional and socio-economic interests. Despite the institutional changes resulting from the Constitutional Treaty and the new institutions and bodies that have been introduced by it, the mode of operation and decision-making in the EU remains negotiation between the associated states of the Union. (Jachtenfuchs 2005)

Negotiation constitutes a way of collective decision-making which is entirely different from voting which is prevalent in parliamentary politics (Scharpf 1997; Elster 1998). Negotiation calls for some ideal characteristics such as the consent of every body involved and for this reason it is necessary for compromise to exist in contrast to voting in which the absolute majority can impose its view. Although the Council all the more decides using weighted majority, votes are used as decision-making means after the necessary compromises have been made. As a consequence, the Council still has a strong tendency to avoid socioeconomic breaches and, thus, to decrease the role of political parties.

- **The Weak Link among governance levels**

A great part of the literature on the EU as a system of multilevel governance adopts two separate while simultaneously connected levels of exercising government policy, that is, the EU level and Member State level. However, the concept of the EU as a governance system which consists of independent levels of exercising policy is misleading as it presupposes that each level possesses the resources and forces to achieve its aims without the need to rely on other levels.

Under this viewpoint, the most typical case is the Council, since, as a decision-making institution, it has been the dominant decision-making institution even after the institutional enhancement of the European Parliament's role. However, the Council is an EU level institution which represents national governments that are accountable to national electorates and therefore this is not a body equivalent to the American Senate, which does not consist of Governors but by senators who are elected specifically for this body. Thus, the representation of regional - state interests in the European Union is much stronger compared to what happens in federal states (Sbragia 1993). This fact, if combined with the fact that the EU not only lacks a monopoly of power that could be used to implement the laws they legislate, also lacks both the personnel and the powers to supervise their observance. Instead, it must rely on Member States to implement its laws and policies as well as to gather its resources.

At the same time, in the EU the two levels of exercising policy are not closely related but rather loosely instead (Benz 2000; Benz 2003). The reason for this is the lack of connection through political parties which do not exist as integrated organizations at both levels while exactly the opposite happens in Germany's federal system.

Although various attempts have been made in order to coordinate the positions of the major parliamentary groups before major meetings of the European Council, the negotiating positions of government representatives in the EU Council have failed to link to a general political effort at an EU level.

## **5. FINANCIAL CRISIS AND THE EU**

The international financial crisis, though it began as an internal crisis of the U.S. estate market and banks, soon spread beyond the U.S. borders. The international financial crisis revealed the weaknesses of the European Union and the operational problems of the Eurozone and evolved into a severe debt crisis in the weaker Eurozone economies, while the debt crisis in the Eurozone revealed the different train of thought among Member States as well.

### **5.1 THE SPREAD OF CRISIS INTO EUROPE**

It was from September 2008 and on that Europe began to feel the repercussions of the financial crisis in the U.S.. It all began when the Dutch bank Fortis found itself one step before bankruptcy and, in order to be rescued, it was partly nationalized in an effort to prevent its absolute collapse, with a cost of 11 billion approximately. The English mortgage bank Bradford and Bingley followed, which was also nationalized to the rescue while it was on the very same date that in Iceland the government was forced to nationalize the third largest bank in the country. On September 30, 2008 these were followed by another European bank, Belgian Dexia, whose rescue cost 6.5 billion to the governments of France, Belgium and Luxembourg. At the

same time, one of the largest German banks, Hypo Real Estate, was on the verge of bankruptcy and its rescue cost about 50 billion Euros.

The European leaders, watching banks running the risk of collapsing one after the other, met in Paris to seek possible actions that had to be taken. Unfortunately, discussions did not lead to joint actions and what was agreed was that each country could take separate action in order to confront the crisis (Political Conditions' 2012 2012).

The emerging situation increased the concern of depositors in European banks as they watched one after the other bank collapse and European governments being forced to rescue them. This fact, particularly in countries with bigger problems such as Greece and Ireland, led depositors to withdraw their deposits en masse, for fear of bankruptcy on the part of the banks or the countries. This event led first Ireland and then Greece to decide to guarantee bank deposits in order to cease withdrawal; subsequently, other European countries followed the same policy, while European leaders agreed to guarantee not only deposits but also loans between banks until the end of 2009. However, the Eastern European countries had undergone excessive lending by Western banks; the Austrian and Swiss banks were exposed by several billion euros and so were Greek banks in the Balkans. During this period, it was widely being claimed that there were about 16 countries whose banking system might need rescuing. In February 2009, a bailout plan amounting to 31 billion dollars was compiled by the European Investment Bank, the World Bank and the European Development Bank in order to rescue banks in central and eastern Europe (Political Conditions' 2012 2012).

In April 2009, the leaders of the 20 largest economies in the world met in London to discuss how to confront the financial crisis. During this meeting there were disagreements as to how the crisis would be managed among the participant European countries. Germany and France emphasized on strict fiscal discipline while the UK identified with the U.S. approach, namely to encourage public spending as a means of managing the economic crisis. However, despite the disagreements, it was certain that Europeans had begun to realize that the financial crisis would not leave Europe unaffected and that what had happened was just the beginning of the crisis in Europe.

## **6. THE GREEK DEBT-CRISIS AND THE SPREAD OF CRISIS INTO THE EU**

The EU realized that its weakest economies may need support. For this reason, a series of contacts took place among the leaders with regard to the actions they should take and the steps they should follow to manage the debt crisis which had begun to become apparent in Europe. One thing was for sure, the disagreements as to what ought to be done were intense. What was though unanimously agreed upon was the prediction about which country would first need the support of the EU. And that was Greece. Indeed, this did not take long to happen. The international financial crisis could not leave Greece unaffected, even though it was late to appear in this country. The EU did not realize the seriousness of the Greek issue on time while even when it was realized, it just tried to buy time instead of acting timely and decisively. In late 2009, the recession became deeper in Greece, whereas the rumors that Greece would need financial aid were thickening; international credit rating agencies downgraded the country's credit rating while the plan involving fiscal discipline, public expenditure reduction and tax revenues increase failed. The European leaders stated that they were ready to offer aid to Greece if they were asked to. In early March the Greek government implemented a new package of measures with the aim of increasing revenue and cutting government expenditures in order to manage the huge increase in deficit; these measures were the last hope to avoid the case of international aid.

During the same period there were many reactions from EU countries which did not participate in the common currency, such as England and Sweden. They did not agree with the financial aid from the EU, arguing that the IMF had the necessary expertise in order to manage crises such as the Greek one and therefore it should take over the rescue of the Greek economy. In April 2010, it was clear that Greece would not be able to pay for its bonds, and that it was then imperative to support its economy, which is why the leaders of the EU countries finally agreed on a 110 billion euro bailout package, known as memorandum, with the participation of the IMF.

The measures imposed on Greece by the Memorandum were under the spirit of the competitiveness pact which had been agreed upon by the German chancellor and the French president a few months earlier, but

eventually failed to meet the expectations, since they plunged the country into a deeper recession and simultaneously increased the risk of diffusing crisis to other Eurozone countries. It was then perceptible in the EU that Greece would not be the only country that needed assistance, as lending rates in the interbank market had already begun to rise for Ireland and Portugal. The EU needed a solution that would effectively be able to support the weaker economies.

In May 2010, when the financial crisis was reaching its climax, the European leaders, fearing the risk of contagion from Greece to other European countries such as Ireland, Portugal, Spain and Italy, decided to create the EFSF, namely the European Financial Stability Facility with 750 billion funds. Meanwhile, the ECB was ready to participate in the bond purchase program from countries at risk, in order to stabilize the euro. On June 24th 2010, it was agreed to increase the EFSF funds to 780 billion euros. The creation of the EFSF had a positive impact on the stability of the euro.

On December 17th 2010, the EC decided to establish the ESM, that is, the European Stability Mechanism, whose purpose was the same as that of the EFSF. The EFSF continues to operate alongside the ESM, until the funding programs of Ireland, Portugal and Greece are completed, but it will not be able to take on new funding programs after June 30, 2013 as this will fall under the responsibility of the ESM.

On November 28th 2010, it was agreed to grant a loan to Ireland in order to safeguard financial stability in the EU.

On April 7th 2011, the Portuguese government, seeing its interest rates soaring, filed a request for financial aid and, thus, became the third country forced to seek the assistance of the European Union.

It already had become clear that Greece's rescue plan did not proceed satisfactorily and for this reason in July 2011 Germany suggested that private investors agree to a 50% loss, accepting a haircut in the value of Greek bonds they had in their possession; so, on 26/10/2011 EU leaders approved the second bailout plan for Greece. The second aid package for the Greek economy cost 144 billion euros.

Cyprus became the fourth member of the EU which filed for financial aid on June 25, 2012, the principal reason for the request being to support its banking institutions. From the period following the events of March 2013 and on, a discussion was being made about the terms and conditions of the loan, which would amount to 10 billion euros, while the entire plan would amount to €16 billion, €6 billion of which would come from a haircut deposits over 100 thousand euros at Cypriot banks.

At the same time, Spain requested aid from the EU to support the Spanish banking sector. The Eurogroup approved the aid to the Spanish banking sector. The rescue plan of Spanish banks has been the first plan implemented by the ESM.

Through the two financial aid packages, the EU protected the Greek economy from default risk; nevertheless, European leaders realized that the Greek plan did not work out and that view was shared by the IMF as well, whose representatives insisted on a more drastic solution, prompting a new deletion of Greek debt, which European leaders would not accept, though. After many negotiations, it was finally agreed to take a series of measures, such as reducing interest rates on loans from the EFSF, lengthening the repayment period of the loans and the return of profits that central banks gained from purchases of Greek bonds. In addition, Greece would repurchase part of its debt at a price less than the face value on the condition that private investors desired to sell their bonds.

## **7. WHAT WILL THE FINANCIAL CRISIS BRING ABOUT IN THE EU'S FUTURE?**

The EU, albeit belatedly, seems to realise the gravity of the situation, but is not yet ready to take the next step which is necessary to confront this critical situation, ie to proceed to its integration. Once again, it seems to be trapped into what is described by Fritz Scharpf in his study of the 'Joint-Decision Trap' (1988) that the process of European integration is at a stage characterized 'by frustration without decomposition and resilience without progress' (Scharpf 1988). That is to say, it has been caught in the trap of joint decision, as today the Member States seem to be divided between North and South ones and an interest enforcement game seems to be played in the EU, based on the economic crisis that has plagued its weakest economies.

The Northern countries bloc, whose main exponent is Germany, occasionally seems to show greater Euroscepticism, even countries such as Great Britain. Statements of this kind have been coming in the limelight by various officials such as Hans Werner Sinn, a professor of economics at the University of

Munich and president of the economic research institute IFO, who strongly supported the Greek exit from the Eurozone. In an interview on Spiegel he claimed that countries which face problems in the Eurozone have to leave temporarily until they restore the competitiveness of their economies. The great fear of all countries with strong economies is to burden their citizens with the indebtedness of financially weaker countries. However, this behavior in many cases activates the anti-European reflexes in other EU countries which feel that within the EU a nucleus of leadership is being created, particularly on the part of Germany since, after the unification of Germany, the question was raised of whether the European integration would constitute the Germanisation of the EU or the Europisation of Germany.

However, the debt crisis in the EU has highlighted its weaknesses once again and this time if it wants to exist in the future, it will have to take the necessary steps in response to the crucial question of whether it wants to be a country or an international organization of regional cooperation.

## 8. THE MAIN AXES OF THE EUROPEAN PERSPECTIVE

As it becomes apparent, the response to the debt crisis of the EU is more Europe, against any intentions shown by Member States. At this point it is worth remembering what Winston Churchill once said: “The structure of the United States of Europe, if well and truly built, will be such as to make the material strength of a single state less important. Small nations will count as much as large ones and gain their honour by their contribution to the common cause...” (Winston Churchill Speech on Council of Europe, 1946).

The steps to be followed by the EU are as follows:

- Banking Union
- Fiscal Union - Economic Union
- Political Union
- Banking Union

It is now imperative that a single European deposit guarantee scheme be created in order to cease the concerns of depositors and stop their withdrawal, which exacerbates the existing problem of liquidity in the market and the SSM mechanism (Single Supervisory Mechanism), ie the single mechanism supervising banking institutions which will help restore confidence in the banking sector, allow the interbank lending market to recover and increase capital flows across borders. In combination with the perspective of directly recapitalizing banks through the ESM and along with the creation of the SRM (Single Resolution Mechanism), that is, a ‘single problem-solving mechanism,’ the preconditions for a deeper banking union that will shield the EU are being founded (Chorafas 2009).

- Fiscal-Economic Union

From the creation of EMU until the emergence of the EU a paradox was created which has become particularly evident during the financial crisis, that is, the existence of a common currency but simultaneously the inexistence of a common economic and fiscal policy for countries participating in the common currency.

This fact has caused many problems to countries like Greece in confronting their crisis, since on the one hand they do not have control over the exchange rate of their currency, so they actually transact in a foreign currency, while on the other hand the issue of monetary policy is under the control of the Eurogroup, in which any decisions on depreciation often impinge on the interests of other states of the EMU.

At the same time, the fact that there is no common economic and fiscal policy reinforces the lack of financial resources from the EU itself, which in this case does not possess the necessary financial resources to deal with such and similar cases, forcing it to seek the involvement of either its member countries, this way leading their citizens to feel they are burdened with the debts of others, or other international financial institutions, leading again to the creation of the perception that it passes debts on the shoulders of others, causing the reaction of the BRICS countries or involving third parties in dealing with its internal affairs. This fact also somehow deprives the EU from the monopoly of violence to enforce its strategic choices about the economy.

It was for this reason that the policies which had been agreed upon failed and the ones agreed lead to failure despite any commitments whatsoever. Such policies moving to the right direction is the Treaty on Stability Coordination and Governance (TSCG), the financial part of the treaty, known as the Fiscal Compact, which is the evolution of the previous Stability and Growth Pact, the ‘European Semester’

according to which in the first half of each year all countries, especially those facing financial problems, will be monitored by the European Commission and the Eurobonds for which the European Union will have to develop an institution that will be able to serve them, as these require besides a common fiscal and economic policy, a political union as well (Arestis 2011).

- Political Union

Of all the objectives that have been set but must be completed, the political union justifiably seems to be the most difficult to achieve. This is not only because of different cultures, different perceptions, different operation of institutions, different economic and fiscal existing conditions but also due to the timidity demonstrated to date and the fact that it comes last on the agenda of European officials. However, even though European politicians are quite reserved on this issue, it is now obvious that the EU needs a stronger law, a more democratic structure and a plan on how to achieve this. For this reason, it is necessary to strengthen the role of the European Parliament and the European political parties with increased responsibilities, without, though, abolishing national parliaments. It is also necessary to strengthen the role of the President and the European Commission, which will resemble a federal government whose support will originate from the European parliament. Finally, the President of the EU ought to have enhanced executive powers.

All the above constitute the prerequisites for a permanent solution that will further shield the EU and will allow its members to move on with safety and development in their shared future, overcoming the financial crisis which revealed its weaknesses in planning, while putting an end to the dilemma between more Europe and no Europe (Auer 2012)

## 9. CONCLUSIONS

The European Commission plans must bridge with technocratic way the gap between what is economically necessary and in what appears to be politically feasible. This approach carries the risk of a growing gap between consolidating regulatory powers on the one hand, and the need to legitimize these increased powers in a democratic manner other. At the beginning of this journey that leads to a supranational democracy in Europe what is needed, first, is a consistent decision to move the European Monetary Union in Political Union, which will remain open, of course, to the accession of other EU Member States. This step could, for the first time to mark a major transformation (diversification) of the Union into a federation.

The feasibility of the necessary changes to the European treaties will mainly depend on the consent of the countries prefer to stay outside. In the worst case, any strong resistance should be overcome only by a reestablishment of the Union (based on existing institutions). The decision for such a Europe stands for something more than a merely evolutionary step in transporting certain sovereign rights. With the establishment of a common economic government the red line of the classical understanding of sovereignty would have crossed. The idea that nation states are "the dominant elements of the treaties" should be abandoned.

On a procedural level, the dethronement of the European Council would mean a move from intergovernmental to the Community method. Since the ordinary legislative procedure, in which Parliament and the Council participate on an equal footing, it has become the general rule, the European Union suffers from a legitimacy deficit such as an international organizations based on transnational conditions. This deficiency is due to the asymmetry between the scope of the democratic credentials of each individual member state and scope of the Agency's powers exercised by all Member States together.

As citizens see the political fate depends on foreign governments representing the interests of other nations rather than a government that is bound only by their own democratic vote. This accountability deficit is compounded by the fact that the European Council negotiations take place outside the public gaze. The Community method is preferable not only because of this regulatory reasons but also in order to improve efficiency. It helps to overcome national differences. In the Council, but also between the stern committees, representatives who are required to defend their national interests, just need to negotiate compromises between powerful positions. In contrast, MEPs, which is divided into parliamentary groups, elected by partisan standpoint. For this reason, as far as a European party system taking shape political decisions in the European Parliament could already be carried out on the basis of generalized interests across national borders.

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# INTERNATIONAL BANKING SUPERVISION AND RETAIL BANK STRATEGIES

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## ABSTRACT

The international banking supervision convergence and implementation process represent one of the most important challenges for the central Bank of Albania and the retail banking system itself. Due to the several economic and financial developments, the supervision agreements have seen they proper evolution through time. In the Albanian banking system you may find a mixed basis of supervisory and prudential norms and agreements between the national and international origins. The question stands: are the international norms an obstacle or an opportunity for the retail banking system development? This paper explores through an empirical assessment the scale of penetration of several supervisory or prudential international norms and most importantly the potential impact that they might have on the banking strategy or the market action-reaction system. The approach that has been taken relies on a qualitative-quantitative analysis based on surveys and individual interviews with members of several Albanian retail banks. Each interview and survey aims to enlist information about the impact of the supervisory norms in a multiple two axis basis: national-international; past-present; conditioning-orientating; cost-profit and so on. The results have been weighted and paralleled with the theoretical development of the matter, to conclude on the real relation between the international banking supervision agreements and national retail banking strategy as well as theirs action field. The further implications of the findings explore interactions on both sides of this relationship.

## KEYWORDS

Banking regulations, Banking supervision, Basel agreement, Retail bank strategy.

## JEL CLASSIFICATION CODES

E58, F33, C83

## 1. INTRODUCTION

The banking system can be seen as an indicator of the “health” of a country’s economy. A sound banking system means an opportunity for investors and tranquility for all economic agents operating, leading to excellent actions and transactions that ensure the best equilibrium of capitals. Although we’re far from the traditional banking, as for the quick changes in the sector, the banking system still remains the core of all financial chains. Starting from this tremendous importance, one cannot allow a failure or a degradation of the banking system. As a matter of fact, the several financial/bank crisis have alerted the need of supervision and regulations<sup>1</sup>, not only on the national ground but also on the international one. Going global has immense opportunities and facilities, but has also implications not only on the level of banking and financial activity but also on behalf of the regulatory and supervision agreements. Logic, to ensure a global harmony, several accords and agreements aim for equality and equitable treatment among international banks in order to avoid abuse and potential failures.

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<sup>1</sup> “Regulations” stands for a set of laws and rules applicable to banking, and “supervision” stands for monitoring by authorities of the banks activities and the enforcement of banking regulations. Barth, Nolle, Phumiwasana and Yago (2003, page 70)

Nobel cause, but the question stands: how do these agreements really impact on the different national basis?! In previous works (Avis Andoni, Financial crisis and banking supervision; the Basel III improvements) I have clearly stated the trend of the banking system or any other financial system, to avoid regulations in order to maximize their profits, creating ruptures in the system and depending on their gravity following potentially by “domino effect” collapses and worldwide crisis. The banking system “needs” supervision, and the most adequate one, no matter the economic environment in which we are located. So, I am pursuing my “research journey” deeply in the real implications of those regulations, apart the scope of doing good, especially in the Albanian case, which is categorized as an emerging market. Indeed, the Albanian banking system has been in permanent transformation. It has been only 17 years since the privatization of the banking system has happened. And afterwards, the Albanian bank market has been “wide open” to foreign investors and foreign banks augmenting so the competitiveness in the market.

For these reasons strategic actions come to ease for everyone of the banks present in the Albanian market being in the same time subject of control and supervision both in the national legislation as in the international regulatory agreements. The purpose of this paper is precisely to “measure” the impact and implications of the international regulations on the strategic specter of the Albanian retail banks. I have to mention that this work/project is still ongoing to complete the procedure with all the Albanian market banks. With the potential findings concerning the impact, this paper focuses on clearing out first of all the scale of awareness of the several international agreements, their real application, the scale of penetration and of course the opportunities or threads presented by them. Do these agreements/accords form or deform the Albanian banking system?!

With this paper you will be able to get a resumed global trend on supervisory and regulatory norms on the banking system, also faced with the Albanian market reality. First you will be finding a targeting through the field of interest. Second, the potential problems will be revealed and the methodology used for this research. Followed at last by the results and conclusion leading to the potential expectations, some critiques and further openings.

## **2. BANKING SUPERVISION AND REGULATIONS**

It has been years now, since the late 1970, that banking supervision is a great deal and very important to either national or international financial and economic harmony. The final destination of all regulations is to protect the depositor. In fact, the depositor is fuel for the motor of the baking engine, without this one, banks wouldn't function. Even though is important to them, the depositor is quickly forgotten, and bankers trend to risk big for bigger profit, needing so an intense supervision and regulation framework. In order to protect the depositor and to ensure the harmony in the system there are several scenarios and risks to be weighted.

We can start from the systemic risk that means the risk of banking panic spreading like a disease in all the banking system, through “healthy” or “unhealthy” banks (solvable or non solvable ones) from their connections and cross activities. That's why the prudential regulations tend to push banks into better understating and not underestimation of the risks they take and supervise the financial structure of their capitals in order to be prepared and cover the potentials losses. The solvability norms are one of the most important of the supervisory framework, and they tend to be more exigent because of the tremendous role of the capital in the stability of the entire banking system in the national ground as well as in the international one, in order to also adopt common standards. The bank's capital influences its solvability, its profitability and of course the risks that will be taken. So the capital ratios based on the risks taken are a very important component of a sound system preventing banks from failure.

In Albania the first private bank to operate was “Banka e Kursimeve” (the Savings Bank) in 1996. In the emerging Albanian market, the financial liberalization raised the first problems and the potential flows that trend to weaken the system. Indeed, in moments of observing vulnerability in the system, institutions and authorities find the need to build a framework; calculating and trying to overcome the risks that a private bank tends to take in order to maximize its profit. The Bank of Albania is in permanent alert to be fitting all the needed and required regulatory and supervisory frameworks connecting the system nationally and internationally, facing loan risk, solvency risk, systemic risk, market risk etc. Nowadays we can count in Albania 16 banks, with foreign parenting, franchised or national capital banks, a mixed composition system being also supervised by mixed frameworks.

Indeed on the international ground, the financial crisis, as negative as they could be, they have inspired the supervisory authorities in improving the regulatory framework from concrete and potential flows. As we speak there exists an international agreement, under the name of Basel iii, where we can find the most important set of changes in the financial services industry to prevent a repetition of the bank collapses of 2007 and 2008. Regulators and central bankers have gathered to determine global safety standards. In fact the Basel iii accord, being the continuum of the first two accords, represents a complex series of reforms, which first of all aim to cover the previous flows and then enrich the accord with updates relevant to the evolution of the financial market itself. The accord is developed in two axes, the micro prudential regulations targeting the individual banking institutions and the macro prudential regulations targeting risks in the entire banking system. The focus is of course the capital that is indeed a “cushion” for unexpected losses. The first thing on the list was de facto the definition of the capital. Under Basel iii there is a tightening in the definition of what can count as capital in order not to artificially overestimate it. The accord aims to strengthen the quality, transparency and consistency of the capital to ensure that banks will be able to absorb losses. In Basel iii the level of minimum capital adequacy has been raised from 4% to 9.5%. Calculation based on risk weighted assets, rose another problem, the correct weighting form the banks. In order to standardize the banks risks, risk weighting is not calculated from the banks models anymore. Basel iii, introduced an internationally leverage ratio, but also liquidity requirements. Until the Lehman Brothers collapsed, there was no liquidity requirement, but now Basel iii introduced a liquidity cover ratio in order to prepare banks in overcoming short term problems<sup>2</sup>. It is precisely the actuality that this accord represent that attires my attention.

### **3. BANKING REGULATION, ALBANIA AND THE IMPLICATIONS**

Fitting all the requirements of the Basel iii accord is truly more expensive for the banks in fact. Why? Having to hold their equity they are forced into lowering their profit. As a matter of fact Basel iii penalizes the high risk activities, logic, as they are found to always be the impulses of potential failures. Indeed I can state that in order to maintain a safe and sound banking, the banking profession should be “boring”. On the other hand in the Albanian case the “problem” doesn’t stand only on the components of the accord but also on the compatibility with the developing economy. Is Basel iii a thread or an opportunity for the Albanian banking system?!

The purpose of this study is precisely to strengthen the knowledge first of all on the development and evolvments in the field of banking supervision and regulations, especially the international ones, which are actually subject of important changes. Second it is very important to detect the scale of penetration of these international regulations on banking supervision. And the most important aim is to detect the “pure influence” of the mentioned regulations on the everyday activity of the retail banks and their strategy. Why do I consider this axis such important to be doing a field research in order to determine the implications? Because f the tremendous cost that this accords have, and the sensibility depending on the scale of development for the economy to be implementing them. If the real influence of the accord happens to be positive and of course considerable, the suggestions following will be a boost in trying to speed up the implementation process.

The approach that has been chosen to use in order to perform this quantification of impact is an empirical assessment. Indeed, I have compiled a survey form and enriched it with several interviews to complete even with informal opinions or “feelings”. The surveys where destined to employees directly coping with the reporting to the central bank and the risk management department that implements several of the proposed norms. Aligned, to enrich the quality of the exact but short response appearing in the survey, I have realized several interviews with members of the top management of several retail banks in Albania.

The interviews deepened the opinion based information on the timing, the comparison, the components being not adapt to the Albanian situating and mostly an opinion on the recommendations for a potential implementation of the Basel iii accord. Afterwards a long process of resuming, analyzing and estimating followed. As a matter of fact in order to well manipulate the data obtained I have been using research

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<sup>2</sup> To get a detailed view of the Basel iii accord you may find it in Annex 1.

methods such as cluster analysis, hierarchic classification, as well as Principal Component Analysis, Factorial Component Analysis and of course the typical cross tabulation analysis<sup>3</sup>.

In order to have a better understanding of the components that will be quantified I would like to guide you through the several sections of the survey. First of all I ask for general information according to the beginnings of the international regulations and supervision in the Albanian banking system. How did their importance evolve and which ones did? I wanted to quantify the awareness of their existence and the way or scale of their implementation. Second, we can find the comparison with the national regulations and supervision. Based on the fact that the Albanian banking system is part of emerging market types and really “late” to all current development worldwide, there are potentially and a priori differences with the international basis accords. What are those differences? Which one is more rigid or flexible? I wanted also to get information from on the real perception if they are seen as limiting, orienting or are just imposed rudely. Is there coherence in their being?

A very important issue is also to deepen the knowledge about the involvement of national economic, social or even cultural components. To be more specific, I have asked the bank employees more questions on certain parts of the regulations. These specific points have been paralleled with the strategic orientation of the bank being studied in order to withdraw information on the most influent components, the real time relation with the strategic action field, the help or obstacles that the regulations incite to the banks strategic actions and also the threads and opportunities that the regulation components represent for them.

Not only I have treated in parallel the evolvement of the personal strategy of the bank and the deviations (positive or negative) caused by the international regulations on banking supervision but I have also found a way to gather a let’s say “wish list” considering their form, measure and scale of penetration. In this way it was much easier to detect the concrete influence of the international prudential regulations. Which ones are the most influent? In which strategy do they mostly interfere? Is there a positive influence or are they purely obstacles? These measurements are importantly paralleled also with the context. At the end of the survey, enriched as stated above by the interviews, the information gathered streams to the agreements or disagreements that banks may have also the suggestions of their part.

#### 4. RESULTS AND CONCLUSION

As I stated it before this study is still in progress to ensure the complete coverage of all the banks in Albania. A considerable part of the information needed was assured and you may find below the most important results.

Table 1. The most important results of cross survey and interview research

The component measured	The converging result	Opinions
The importance of the supervisory regulations	Growing	The national or international regulations are seen as really important, and this importance is growing while the market itself is in perpetual trend of failure
The regulations being applied	Mixed between national/international	The actual situation imposes a mixed system of regulations, national ones being mandatory, and international ones being orientating or depending on the bank mandatory from the “mother” banks
The comparison	The Albanian regulations being more strict in some point (coverage on RWA) The international regulations being more detailed and richer in plenty of missing components of our market	The most important financial product of the Albanian banks (being almost the only one) is the classic loan, and the Albanian banks cover it in collateral 90-110%. Not yet a stock market, so lack of several financial products/services.

(cont.)

<sup>3</sup> I would like to inform that the final results aren’t yet reached because of the big amount of time needed to obtain the survey forms.

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The evolution	Relatively quick / more and more	The large penetration of the foreign banks and their “spirit” make evolving the market and its needs fast enough to be requiring an evolved supervision also.
The most changing components	Liquidity and Risk (operational and credit)	Due to the actuality the past crisis these two components are the core alert for prudential regulations, being revised and updated especially the operational risk that is a “new entry”.
The perception of the comparison	Different among banks	Depending on the ownership of the bank, views and perceptions are different because of the importance being given by the foreign banks to the common international standards.
The most known accords	FSB, BCBS, EU Directives	Still being some employees that have not quite the complete information on international directives and authorities responsible for the supervision regulations.
Strategic canalization	Their influence on the strategic sphere is augmenting	The prudential and supervision regulation re being more and more strict and detailed so the specter of their influence is apprehended as augmenting and influencing directly some of the strategic decision making of several banks.
The prudential weight	Growing / as a result of the international economic situation	Directives are being transformed from orientating to obligatory because of the economic development worldwide.
Approaching Basel II	More and more	While other countries are started the implementation of Basel iii, in the Albanian market is Basel ii that is still on call.
Concrete obstacles	Limitations Reducing the decision making horizon Reducing profitability Conditioning the international exposition Conditioning the investment’s plans	As a matter of fact, the Albanian market has been a “free ground” for foreign investments in banks, not being strictly frame worked in international common regulations and having the freedom of “playing” in exposition and profitability, so on the shareholders side, as everywhere else, these regulations are being seen more as an obstacle.
Advantages	Ameliorating the CARs Orienting to the international markets Orienting the risk models	On the other side, the bank employees prefer this international guidance because of the evolved and developed research on risk models and advanced market products and trends.
The most concerned strategies	Diversifications Specification Internalization Expansion	The bank size or its scale of penetration in the market models the bank’s strategy so it is clear that depending on that the precise strategy being canalized and modified due to the regulations are different.
Wish list	Lightening Changing according to the economic context Changing according to the Albanian market components Taking notice of the national culture and regulations	The most important suggestion is to take consideration of the Albanian market, the economic and social situation, in order to best adapt the regulations. The point of incoherence being the incompatible market types in emerging markets.

Based on this study, which is still in progress, I will be able to get further detailing on the strategic interactions. The limitations of this kind of studies are for sure the “shyness” or fear of the interviewed individuals that sometimes tend to lie and cover the truth. On the other hand the most “loquacious” individuals represent a positive advantage of the interviews. Overall, the most important result of this research is for sure the immense importance given to the prudential and supervisory regulation being either national or international. The impact of these regulations on the banking strategic actions exists and this impact is positive for the banking system’s health. As long as the prudential framework is seen as an obstacle for shareholders, the depositor is safer, even though sometimes the cost will be absorbed by this last one. So, in order to deepen the research and determine if Basel iii is really the “salvation boat” to overcome future

collapses I will pursue on other axis such as the implementation cost, the opportunity cost, and of course the compatibility with emerging market type. Is it worth? Is it needed? Is it in the right place? We will see.

## ACKNOWLEDGEMENT

I want to especially thank Dr. Elvin Meka for helping me out in several tasks and also I would like to thank the staff of the Albanian banks that have welcomed me to extract the information needed for this work.

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ANNEX

Basel iii framework						
Capital						Liquidity
Pillar 1			Pillar 2		Pillar 3	Global liquidity standard and supervisory monitoring
Capital	Risk coverage	Cointaging leverage	Risk management and supervision	Market discipline		
<p><u>Quality and level of capital</u> Greater focus on common equity. The minimum will be raised to 4.5% of risk-weighted assets, after deductions.</p> <p><u>Capital loss absorption at the point of non-viability</u> Contractual terms of capital instruments will include a clause that allows – at the discretion of the relevant authority – write-off or conversion to common shares if the bank is judged to be non-viable. This principle increases the contribution of the private sector to resolving future banking crises and thereby reduces moral hazard.</p> <p><u>Capital conservation buffer</u> Comprising common equity of 2.5% of risk-weighted assets, bringing the total common equity standard to 7%. Constraint on a bank's discretionary distributions will be imposed when banks fall into the buffer range .</p> <p><u>Countercyclical buffer</u> Imposed within a range of 0-</p>	<p><u>Securitisations</u> Strengthens the capital treatment for certain complex securitisations. Requires banks to conduct more rigorous credit analyses of externally rated securitisation exposures.</p> <p><u>Trading book</u> Significantly higher capital for trading and derivatives activities, as well as complex securitisations held in the trading book. Introduction of a stressed value-at-risk framework to help mitigate procyclicality. A capital charge for incremental risk that estimates the default and migration risks of unsecuritised credit products and takes liquidity into account.</p> <p><u>Counterparty credit risk</u> Substantial strengthening of the counterparty credit risk framework. Includes: more stringent requirements for measuring exposure; capital incentives for banks to use central counterparties for</p>	<p><u>Leverage ratio</u> A non-risk-based leverage ratio that includes off-balance sheet exposures will serve as a backstop to the risk-based capital requirement. Also helps contain system wide build up of leverage.</p>	<p><u>Supplemental Pillar 2 requirements.</u> Address firm-wide governance and risk management; capturing the risk of off-balance sheet exposures and securitisation activities; managing risk concentrations; providing incentives for banks to better manage risk and returns over the long term; sound compensation practices; valuation practices; stress testing; accounting standards for financial instruments; corporate governance; and supervisory colleges.</p>	<p><u>Revised Pillar 3 disclosures requirements</u> The requirements introduced relate to securitisation exposures and sponsorship of off-balance sheet vehicles. Enhanced disclosures on the detail of the components of regulatory capital and their reconciliation to the reported accounts will be required, including a comprehensive explanation of how a bank calculates its regulatory capital ratios.</p>		<p><u>Liquidity coverage ratio</u> The liquidity coverage ratio (LCR) will require banks to have sufficient high-quality liquid assets to withstand a 30-day stressed funding scenario that is specified by supervisors.</p> <p><u>Net stable funding ratio</u> The net stable funding ratio (NSFR) is a longer-term structural ratio designed to address liquidity mismatches. It covers the entire balance sheet and provides incentives for banks to use stable sources of funding. Principles for Sound Liquidity Risk Management and Supervision The Committee's 2008 guidance</p> <p><u>Principles for Sound Liquidity Risk Management and Supervision</u> Takes account of lessons learned during the crisis and is based on a fundamental review of sound practices for managing liquidity risk in banking organisations. Supervisory monitoring The liquidity framework includes</p>

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	<p>2.5% comprising common equity, when authorities judge credit growth is resulting in an unacceptable build up of systematic risk.</p>	<p>derivatives; and higher capital for inter-financial sector exposures.</p> <p><u>Bank exposures to central counterparties (CCPs)</u> The Committee has proposed that trade exposures to a qualifying CCP will receive a 2% risk weight and default fund exposures to a qualifying CCP will be capitalised according to a risk-based method that consistently and simply estimates risk arising from such default fund.</p>				<p>a common set of monitoring metrics to assist supervisors in identifying and analysing liquidity risk trends at both the bank and system-wide level</p>
<p>SIFIs</p>	<p>In addition to meeting the Basel III requirements, global systemically important financial institutions (SIFIs) must have higher loss absorbency capacity to reflect the greater risks that they pose to the financial system. The Committee has developed a methodology that includes both quantitative indicators and qualitative elements to identify global systemically important banks (SIBs). The additional loss absorbency requirements are to be met with a progressive Common Equity Tier 1 (CET1) capital requirement ranging from 1% to 2.5%, depending on a bank's systemic importance. For banks facing the highest SIB surcharge, an additional loss absorbency of 1% could be applied as a disincentive to increase materially their global systemic importance in the future. A consultative document was published in cooperation with the Financial Stability Board, which is coordinating the overall set of measures to reduce the moral hazard posed by global SIFIs</p>					

# THEORETICAL AND PRACTICAL APPROACH IN ESTIMATING CAUSAL EFFECTS

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## ABSTRACT

The main hindrance to modeling the causality arises from the basic problem of the causal inference, saying that for an individual we cannot simultaneously observe (1) the outcome when the individual receives the treatment and (2) the outcome when the individual does not receive the treatment. Due to that, we cannot observe the outcome for such an individual at the same time in the event of the treatment and in the event of the absence of treatment. Basically, each causal inference includes a comparison of the actual outcome with the counterfactual outcome. We cannot say anything about the causal effect if we do not have the record on the counterfactual status. The problem of the treatment effect assessment may actually be defined as a problem of missing data. We have observed the outcomes of individuals participating in the employment program and the outcomes of those not participating in the employment program. To know the “true” effect of the employment program on a particular individual, we must compare the observed outcome with the outcome that would have resulted had that individual not participated in the employment program. However, only one outcome is actually observed. What would have resulted had the individual not received treatment (the counterfactual result) cannot be observed. Information on nonparticipants can be used to derive the counterfactual result for participants. The practical approach in this paper refers to the implementation of the propensity score matching technique using statistical package to estimate the causal effects of the employment program.

## KEYWORDS

Causal effects, estimation, employment program, propensity score.

## JEL CLASSIFICATION CODES

C54, J08, J64.

## 1. INTRODUCTION

When trying to estimate the causal effect the treatment and control group must be matched in such a way that they only differ in the treatment received, but are otherwise identical on all other characteristics. If this is not the case, then the estimated treatment effect may be biased. One way to solve the problem is randomization which statistically equates treatment and control groups such that the distribution of all observed, but also all unobserved baseline covariates is the same for both groups. When randomization is not possible or individual causal effects are of interest we need to match cases individually on observed baseline covariates. Matching can be defined broadly as any method that aims to equate or balance the distribution of covariates in the treated and control groups (Stuart, 2010).

In this paper we focus on the evaluation problem which is present when trying to estimate causal effect and is sometimes referred as a missing data problem. In the core of the evaluation problem there is a basic problem dealing with causality which states that for an individual we cannot simultaneously observe (1) the outcome when the individual receives the treatment and (2) the outcome when the individual does not receive the treatment. Due to that, we cannot observe the outcome for such an individual at the same time in the event of the treatment and in the event of the absence of treatment. Rubin causal model offers a convenient framework for defining causal quantities and deriving corresponding estimators as well as the assumptions required for warranting a causal interpretation of matching estimates. There are several matching techniques and propensity score techniques available to deal with the above mentioned problem. Propensity score

matching technique is applied in the practical example showing also the usage of Matching as a R package. The paper is structured as follows: 1) Introduction, 2) The evaluation problem, 3) Rubin causal model, 4) Propensity score matching, 5) Practical example and 6) Conclusion.

## 2. THE EVALUATION PROBLEM

We are interested in measuring the effect of the employment program (our treatment variable) on the participants' chances of finding a job. This problem can be seen as a specific case of the more general evaluation problem dealing with causality (Angrist and Krueger, 1999; Barnow, Cain and Goldberger, 1980; Briggs, 2004; Caliendo and Hujer, 2006; Cameron and Trivedi, 2005; Dehejia and Wahba, 1999). The main hindrance to modeling the causality arises from the basic problem of the causal inference, saying that for an individual we cannot simultaneously observe (1) the outcome when the individual receives the treatment and (2) the outcome when the individual does not receive the treatment. Due to that, we cannot observe the outcome for such an individual at the same time in the event of the treatment and in the event of the absence of treatment. Basically, each causal inference includes a comparison of the actual outcome with the counterfactual outcome. We cannot say anything about the causal effect if we do not have the record on the counterfactual status. The problem of the treatment effect assessment may actually be defined as a problem of missing data (Baltagi, 1995; Hujer and Caliendo, 2000; Ichino, 2006).

We observe the outcomes of individuals participating in the employment program and the outcomes of those not participating in the employment program. To know the »true« effect of the employment program on a particular individual, we must compare the observed outcome with the outcome that would have resulted had that individual not participated in an employment program. However, only one outcome is actually observed. What would have resulted had the individual not been treated -the counterfactual- cannot be observed (Ackum, 1991; Ashenfelter, 1978; Barron, Berger and Black, 1997; Fraker and Maynard, 1987). And this is precisely what gives rise to the evaluation problem. Yet, information on non-participants can be used to derive the counterfactual for participants.

Before stating how this idea can be implemented, it is important to specify the parameters of interest when estimating treatment effect. Three types of estimates are mentioned in the literature (Heckman et al., 1996; Imbens and Angrist, 1994). In this paper, we will focus on the impact that the public work program has on individuals who were actually treated – the average effect of treatment on the treated (hereafter referred to as ATT). However, one could also be interested in the effect of the public work program on a random individual – the average treatment effect (ATE). These two effects are identical, if we assume homogeneous responses to treatment among individuals; should the responses be allowed to vary across individuals, ATT and ATE would differ. The third parameter of interest is known as the local average treatment effect, or LATE (Imbens and Angrist, 1994); it measures how a treatment affects people at the margin of participation, that is, it gives the mean effect of a program on those people whose participation changes as a result of the program. In the empirical analysis we will therefore focus on ATT only.

## 3. RUBIN CAUSAL MODEL

Rubin causal model (Rosenbaum and Rubin, 1983, 1984) with its potential outcomes notation offers a convenient framework for defining causal quantities and deriving corresponding estimators as well as the assumptions required for warranting a causal interpretation of matching estimates. Rubin causal model also has the advantage that it emphasizes the counterfactual situations of the units in the treatment or control condition. The questions to be answered are (see Table 1): a) “What would the outcome of the treated units have been had they not been treated?” and b) “What would the outcome of the untreated have been had they been treated?”.

Table 1. Outcome notation

Group	$Y^1$	$Y^0$
Treatment (D=1)	observable	(counterfactual)
Control (D=0)	(counterfactual)	observable

The formal framework of Rubin causal model can be represented as follows: each unit  $i$  has two potential outcomes: the potential control outcome  $Y_i^0$  under the control condition ( $D_i=0$ ) and the potential treatment outcome  $Y_i^1$  under treatment condition ( $D_i=1$ ).  $Y_i^1$  and  $Y_i^0$  are called potential outcomes because these are the unknown but fixed outcomes before unit  $i$  gets assigned or selects into the treatment or control condition. After treatment, only one of the two potential outcomes is revealed the potential treatment outcome for the treated and the potential control outcome for the untreated. The respective other potential outcomes remain hidden. Given the pair of potential outcomes ( $Y^0, Y^1$ ), two causal quantities are frequently of main interest: the average treatment effect for the overall target population or sample (ATE) and the average treatment effect for the treated (ATT) (Nannicini, 2007):

$$ATE = E(Y^1 - Y^0) = E(Y^1) - E(Y^0)$$

$$ATT = E(Y^1 - Y^0 | D = 1) = E(Y^1 | D = 1) - E(Y^0 | D = 1)$$

In practice, the choice of the causal quantity of interest depends on the research question, whether the interest is in estimating the treatment effect for the overall target population or the treatment effect for the treated units only. If we were able to observe both potential outcomes we could determine the causal effect for each unit, that is  $Y_i^1 - Y_i^0$ , for  $i=1, \dots, N$ , and simply estimate ATE and ATT by averaging the difference in potential treatment and control outcome. But in practice we never observe both potential outcomes ( $Y^0, Y^1$ ) simultaneously which is referred as fundamental problem of causal inference. Since the outcome we actually observe for unit  $i$  depends on the treatment status, we can define the observed outcome as:

$$Y_i = Y_i^0(1 - D_i) + Y_i^1 D_i$$

At the group level, we can only observe the expected treatment outcome for the treated and the expected control outcome for the untreated. These conditional expectations differ in general from the overall averages  $E(Y^1)$  and  $E(Y^0)$  due to differential selection of units into the treatment and control condition - the problem of selection bias. The estimator is only unbiased if the design and implementation of a study guarantees an ignorable selection or assignment mechanism (Wooldridge, 2002). One way of establishing an ignorable selection mechanism is to randomize units into treatment and control conditions. Randomization ensures that potential outcomes are independent of treatment assignment  $D$ . Randomization also ensures independence of all other observed and unobserved baseline characteristics from treatment assignment which implies that the treatment and control groups are identical in expectation on all baseline characteristics. In practice, randomization is frequently not possible due to practical, ethical or other reasons such that researchers have to rely on observational studies.

In such studies, treatment assignment typically takes place by self, administrator or third person selection rather than randomization and this very likely results in treatment and control groups that differ not only in a number of baseline covariates, but also in potential outcomes. In such a case we need a carefully selected set of observed covariates  $\mathbf{X}$  such that potential outcomes are independent of treatment selection conditional on  $\mathbf{X}$ . If we observe such a set of covariates and if treatment probabilities are strictly between 0 and 1, the selection mechanism is said to be strongly ignorable. The strong ignorability assumption is frequently called conditional independence assumption (CIA), unconfoundedness or selection on observables. From a practical point of view, this means that we have to observe all covariates  $\mathbf{X}$  that are simultaneously associated with both treatment status  $D$  and potential outcomes ( $Y^0, Y^1$ ). If this is the case, treatment selection is said to be ignorable and statistical methods that appropriately control for these confounding covariates are potentially able to remove all the bias.

#### 4. PROPENSITY SCORE MATCHING

The underlying principle consists of matching treatment with comparison units (i.e. individuals participating in the employment program vs. those not participating in the employment program) that are similar in terms of their observable characteristics. This approach has an intuitive appeal, but rests on a very strong assumption: that any selection of unobserved variables is trivial in the sense that the latter do not affect outcomes in the absence of treatment (Vandenberghe and Robin, 2004). This identifying assumption for matching is known as the conditional Independence Assumption (CIA). Under the CIA, estimators relying on matching techniques can yield unbiased estimates of ATT. They allow the counterfactual outcome for the treatment group to be inferred and therefore for any differences between the treated and non-treated to be attributed to the treatment. For a more detailed discussion on the matching technique see, for example, Becker and Ichino (2002), Cameron and Trivedi (2005), Chemin (2008).

#### 5. PRACTICAL EXAMPLE

Practical example focuses on showing the usage of Matching (Sekhon, 2011) as a R package. R is a language and environment for statistical computing and graphics. It is a GNU project which is similar to the S language and environment which was developed at Bell Laboratories (formerly AT&T, now Lucent Technologies) by John Chambers and colleagues. R provides a wide variety of statistical (linear and nonlinear modelling, classical statistical tests, time-series analysis, classification, clustering, ...) and graphical techniques, and is highly extensible. R is available as Free Software under the terms of the Free Software Foundation's GNU General Public License in source code form. R is an integrated suite of software facilities for data manipulation, calculation and graphical display. It includes:

- an effective data handling and storage facility,
- a suite of operators for calculations on arrays, in particular matrices,
- a large, coherent, integrated collection of intermediate tools for data analysis,
- graphical facilities for data analysis and display either on-screen or on hardcopy, and
- a well-developed, simple and effective programming language which includes conditionals, loops, user-defined recursive functions and input and output facilities

R is designed around a true computer language, and it allows users to add additional functionality by defining new functions (cited from <http://www.r-project.org/>). Whereas Matching (Sekhon, 2011) is a R package which provides functions for multivariate and propensity score matching and for finding optimal covariate balance based on a genetic search algorithm.

Data for our practical example comes from official database kept by Statistical Office of the Republic of Slovenia. Database is a random sample of 4746 unemployed persons out of which 528 participated in public work program (referred as treated). Whether unemployed person participated in public work program or not we denote this with a binary treatment indicator stating 0 for untreated and 1 for treated person. Our outcome of interest is the probability of being employed one year after the program start. Other variables included in the analysis are age, gender, level of education, region and duration of unemployment. The latter is considered as a variable to show unemployment history. Following the procedure suggested by Sekhon (2011) we used one to one matching with replacement and called for balance statistics which showed that there are small difference before and after matching. The estimated average treatment effect for the treated performed with propensity score matching was -0,07 (P=0,19) and was statistically insignificant at 0,05.

#### 6. CONCLUSION

This paper gives a short overview of estimating causal effects. When trying to estimate for example the effectiveness of active employment programs these are the issues which have to be discussed. Each unemployed person does not automatically participate in some active employment program. Especially in observational studies treatment assignment typically takes place by self, administrator or third person

selection rather than randomization and this very likely results in treatment and control groups that differ not only in a number of baseline covariates, but also in potential outcomes. In such a case we need a carefully selected set of observed covariates such that potential outcomes are independent of treatment selection conditional on observed covariates. This paper also provides an application of propensity score matching to estimate causal effect with Matching as a R package. Recent advances have made advanced matching methods more and more accessible. Therefore, our application could also be done with some other R package supporting propensity score matching and which operate on a free basis.

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