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The Competitiveness Evaluation of CEE Countries

Art Kovačič

In the article I will evaluate the competitiveness position by quantitative and by qualitative methods. An evaluation of qualitative competitiveness of CEE countries can give important insights to the most important development steps in the near future. This is especially important in view of the next steps in the enlargement process of the EU. The European Union's prosperity is based on its capacity to compete in the global market. For this reason, we need to measure and study our economy's position in terms of competitiveness. Competitiveness creates the necessary conditions for sustainable development, for the creation of new production activities and new jobs, and for a better quality of life. We can evaluate the competitive position of selected countries by WEF of IMD competitiveness report. Slovenia, Slovakia, Czech R. Romania and Hungary are located in Central Europe. These countries have the same historical backgrounds in Austro-Hungarian empire. The well developed classical infrastructure and good educational system can be explained through historical reasons. Today we have a well developed competitiveness methodologies for evaluation. It is interesting to discover are the CEE countries still close after EU integration process. One way to evaluate the qualitative competitiveness of CEE countries is to illustrate competitive environmental frameworks using the data for CEE economies and some European countries. The factors in the proposed framework are index measures calculated from perceptual variables collected by executive surveys. In order to rank factors of competitive environmental frameworks for selected countries we use the Standard Deviation Method, which can accurately assess the relative differences between countries' performances. Indexes give as a picture of the competitiveness position of selected group.

Key words: productivity and competitiveness, benchmarking, development strategy, national development

JEL classification: 011, 024, 038, 057

1. INTRODUCTION

After European integration process can be seen the competitiveness level of CEE countries are still very similar. European internal market and the European policies have forced the competitiveness determinant in CEE countries. Slovenia, Slovakia, Czech R., Romania and Hungary are located in Central Europe. These countries have the same historical backgrounds in Austro-Hungarian empire. The well developed classical infrastructure and good educational system can be explained through historical reasons. Today we have a well developed competitiveness methodologies for evaluation. It is interesting to discover are the CEE countries still close after EU integration process. In the article the competitiveness will be evaluated for CEE countries. Differences are very clear among CEE countries, raising doubts about the growth potential of the Central Europe, and pointing towards a possible critique of the strategies that have been adopted in the time of accepting *Acquis Communautaire* and European policies on many fields. Three hypotheses will be tested in the article: First hypothesis is that enlargement process improves the institutional competitiveness. The second hypothesis is that indexes allow us to evaluate the qualitative competitiveness. The third hypothesis is that European internal market has changed the trade structure in CEE countries.

A discussion of the implications of modern economic growth theory and comparisons with the growth paths of rapidly advancing market economies suggests some consistent weaknesses, although there are differences of degree between the individual countries. Competitiveness depends on shareholder and customer values, financial strength which determines the ability to act and react within the competitive environment and the potential of people and technology in implementing the necessary strategic changes. While there are many theories about competitiveness and related interdisciplinary fields of strategy, operations, policies, organizations, they are not used widely by practitioners in their decisions for enhancing or sustaining competitiveness. Research efforts have brought many interesting perspectives and

frameworks at the country, industry, and firm level. The popularity of the competitiveness benchmarking at the country level such as Global Competitiveness Reports (WEF), World Competitiveness Yearbooks (IMD), and National Competitiveness Reports is an indicator of growing interest in comprehensive frameworks and data for competitiveness-related decision-making.

Competitiveness is a broad concept, which can be observed from different perspectives: through products, companies, branches of the economy, the short-run or the long-run. The most complex of these is the concept of the competitiveness of the national economy. Some authors even negate its importance, particularly in a system of floating exchange rates. For example, Krugman (1994) sees the competitiveness of the national economy as a dangerous obsession, and similarly, Porter claims that national productivity is the only meaningful concept of competitiveness at the state level. States and companies should be viewed equally, as international trade is not a zero sum game and because states cannot be competitive in all branches of economic activity (Porter, 1990). The concept of competitiveness is somewhat elusive particularly at the national level. There is an on-going academic debate over the merits of emphasising price (i.e., exchange rates and wages) and non-price factors (i.e., technology, design, productivity, human capital etc.) in such a definition. Following the OECD define competitiveness as: "the degree to which, under open market conditions, a country can produce goods and services that *meet the test of foreign competition* while simultaneously maintaining and expanding domestic real income (OECD, 1992). The first Competitiveness Advisory Group appointed by the European Commission argued that competitiveness implies elements of productivity, efficiency and profitability and is a powerful means of achieving rising standards of living and increasing social welfare. The critical determinants of competitiveness are productivity improvements, and technological innovation. Similarly, Scott and Lodge argue that since World War II, the shift of industrial activity towards science-based enterprises such as electronics or chemicals

means that national competitiveness is increasingly dependent on technology, capital investment, and labour skills. Unlike previous determinants of national competitive advantage, these factors are not naturally dependent on any particular region or nation state. These resources are internationally mobile and can be attracted and shaped by any state which has a suitable enterprise culture, liberal trade and investment laws, a strong scientific and technical infrastructure, and a good educational system (Lawton, 1999). Competitiveness is more and more a matter of strategies and structures, and less and less a product of natural endowments. Competitiveness development is based on an understanding of the nature of technological change in the business enterprise sector. As discussed below, it focuses on the issue of learning costs to absorb technological and other manufacturing capabilities in enterprises in industrial latecomers. The pace at which enterprises acquire these capabilities is reflected in shifts in comparative advantage at the country-level. Thus, national competitiveness can be proxied by manufactured export performance relative to competitor economies. A more competitive economy is characterized by *rapid manufactured export growth combined with sustained technological upgrading and diversification*. This is a measurable notion, which emphasizes both growth performance and structural change over time in the manufacturing sectors of individual open economies. Moreover, it emphasizes efficiency considerations and gives rise to policy suggestions. Similarly, competitiveness policy can be viewed as the sum of policy instruments, which may induce more rapid export growth and technological upgrading in a country's enterprises. The need to improve our competitiveness is not imposed by Government, but by changes in the world economy. Improving competitiveness is not about driving down living standards. It is about creating a high skills, high productivity and therefore high wage economy where enterprise can flourish and where we can find opportunities rather than threats in changes we cannot avoid. Many governments seriously peruse national competitiveness rankings produced by WEF or IMD. The study of competitiveness strategy is now a very important obligation of government. All new member countries

have high-level official committees to deal with competitiveness, reaching across ministerial divisions to devise international, national or regional policy. The concept of competitiveness and competitive strategy comes from the business school literature. Companies compete for markets and resources, measure competitiveness by looking at relative market shares, innovation or growth and use competitiveness strategy to improve their market performance. The competitive society, in sociological terms, is the society which can achieve a dynamic balance between wealth creation and social cohesion. The available literature on national competitiveness increasingly views competitiveness strategy in holistic terms, involving the use of several related policies (Fagerberg 1996). This literature typically rejects the view found in popular discourses that a single instrument can achieve a major improvement in national competitiveness. Following this literature, this paper emphasizes a holistic approach to national competitiveness policies, which has two elements: a three-way national partnership (involving complementary actions by government, the private sector and labour organization) for national competitiveness.

What makes for competitiveness in a country's economy? The NCC report uses a particularly enlightening model for understanding the role of competitiveness, which it likens to a pyramid. At the bottom, forming the foundation of the economy, are five "inputs", the primary drives of competitiveness. These are: business and work environment, economic and technological infrastructure, education and skills, entrepreneurship and enterprise development, and innovation and creativity. This is where policy-makers can have the greatest effect on competitiveness. The second level of the pyramid, which the report calls the intermediate stage, contains four building blocks which can be regarded as the direct outcomes of processes at the bottom. They are productivity, prices, wages and costs. Where favourable, they add up to what we mean by competitiveness. At the top level we find the "outputs", the benefits that we expect competitiveness to bring to society in the form of quality of life, sustainable development and so on

(Annual competitiveness report 2003, 2003). General definition of competitiveness concept involves also defining its range, which can be reviewed in three major groups: (1) local (regional) competition-range of suppliers of a product or a service is limited to the closest surroundings (often characteristic to the market of services); (2) internal (national) competition-domestic companies supply a product or a service (characteristic to the internal market protected by foreign trade restrictions); (3) international (global) competition-suppliers of a product or a service might come from all over the world. The term »international competitiveness« refers to the fact that in reality the stage of competitiveness is tested only on the world market (Garelli, 1997). Most of the studies mentioning competitiveness of a nation present the factors used to measure the competitiveness, however, the concept itself is not defined. It is impossible to carry out correct measurement and interpret the results adequately when the goal is not defined. The emphasis on »competitiveness« threatens to pervade all aspects of economic and social life. This is true for companies and nations, whether their activity is in the internationally traded goods sector or not, whether goods are privately produced or collectively provided: all are now equally subject to the criteria of the discourse of competitiveness. Company strategy and public policy are alike concerned to match supposed international challenges. This is also increasingly so for individuals, who are also required to become competitive in the way they conduct their lives, these demands going under the headings of being flexible, innovative, imaginative entrepreneurial, and so on.

The European Union's prosperity is based on its capacity to compete in the global market. For this reason, we need to measure and study our economy's position in terms of competitiveness. Competitiveness creates the necessary conditions for sustainable development, for the creation of new production activities and new jobs, and for a better quality of life. We can evaluate the competitive position of selected countries by WEF of IMD competitiveness report.

2. METHODOLOGY OF QUALITATIVE COMPETITIVENESS

One way to evaluate the qualitative competitiveness of CEE countries is to illustrate competitive environmental frameworks using the data for CEE economies and some European countries. The factors in the proposed framework are index measures calculated from perceptual variables collected by executive surveys. In order to rank factors of competitive environmental frameworks for selected countries we use the Standard Deviation Method, which can accurately assess the relative differences between countries' performances. The method is also used in competitiveness reports to calculate overall, factor and sub-factor rankings of competitiveness. Indexes give as a picture of the competitiveness position of selected group. The world market is becoming more important. Because of the dynamism of trade we can evaluate the development stage of the country with the analysis of the export-import flows. Trade performance of a country is a good indicator of development stage. International trade could support the growth of BDP. Usually we measure trade performance with some indicators like openness of a country or the growth of export. It is also generally recognized that openness to trade can play an important role in helping nations to achieve greater prosperity. In this regard, a number of studies have explored the relationship between free trade and economic growth (Sachs, Warner 1995). Although it is indeed true that opening to trade does not always lead to higher growth, it also seems clear that the variation in national experiences stem in large part from differences in the internal conditions of the countries in question. Among these differing conditions are critical factors such as governance, the quality of institutions, levels of education and health, and law and order. We can say that it is hard to finance welfare state without high quality of export. The success on international markets, which is measured by export shares, is an indicator of integration in global trade. The structure of an industrial export is the result of production capacity, the quality of management, innovation system, business cul-

ture and institutional environment. In the short term on the export success could influence the quality of makroeconomic management, specially exchange rate. From a dynamic perspective, the change in the country's sector-specific share in world exports is obviously significant. Similarly, the ability of exporters to increase their sectoral trade surplus or reduce their deficit sheds light on the evolution of competitive advantages. In addition, the degree of specialization in particularly dynamic products within a given sector is closely related to trade competitiveness. Moreover, changes in product differentiation and market diversification capture the dynamics of trade competitiveness.

For evaluation of competitiveness we must find the real reasons for changed trade flows. Firms could be competitive if the market shares are growing. On the other side we can say that export articles are dynamic, if export shares are growing faster than average. If a country is a successful in information technology sector, than the all industry has the qualtative improvement. We can expect a good influence on all export. Differences in technology are thus at the centre of explanations of specific patterns in international trade, but in contrast to the »new« theories, the static Ricardian model takes technology as exogenous and characterised by constant returns to scale. Technology differences between countries are given and their evolution not further explained. To put it with the words of Grossman-Helpman (1995) until quite recently, the formal trade theory has focused almost exclusively on the effects of technological disparities without delving much into their causes. Sustainable growth is made feasible by the assumption of some kind of technological externality; that is, the creation of knowledge through private R&D yields positive external effects so that the social return on investment in R&D exceeds the prive return. The new knowledge thus adds to the public stock of technological knowledge and is sccessible to all firms doing R&D themselves. Without the assumption of technological externalities innovatiors would be in a position to establish permanent monopolies without any further R&D effort. Ongoing innovation requires sustained increases in re-

search productivity. If opportunities for learning are bounded or the learning process runs into diminishing returns, then the engine of technological progress must eventually grind to a halt (Grossman-Helpman, 1995).

Technological differences are thus one of the main sources of national competitive advantages. The more unique and sophisticated a firm's technology and products are, the greater and easier to defend will be the firm's monopoly power and the higher will be the mark-ups on costs. Countries at the other end of the »quality ladder« will have to specialise at the lower end of the quality spectrum and compensate their relative technological backwardness by lower wages or higher usage of energy or environmental resources, where competitiveness mainly builds on favourable manufacturing cost conditions and low price strategies (Wolfmayr-Schnitzer, 1998). We apply the trade classification method introduced by Legler (1982) and further elaborated by Schulmeister (1990) and Schulmeister-Bosch (1987) to discriminate between high-tech and low-tech sectors and the different sophistication of goods according to the main inputs used (human capital, physical capital, labour, other resources). If countries compete successfully in high-tech industries and focus on markets in which quality and know-how are more important than low-price strategies we speak about technological competitiveness, one aspect of qualitative competitiveness. Typical, repeated combinations of attributes among the various product groups in the Legler classification (R&D intensive goods are always human capital intensive, resource intensive goods are always capital intensive). Schulmeister classification thereby distinguishes four main hierarchies of technologies (human capital, physical capital, labour, other resources) which are further subdivided into subgroups. The four main groups are:

- 1) »Human capital intensive industries«: Product groups in which the input of qualified labour exceeded the average intensity by 10 per cent were summed up under this heading. In a further differentiation high technology and medium technology groups

which again can be more capital or labour intensive, were distinguished using expert judgement. Examples of product groups belonging to the high technology group are aeroplanes, optical instruments, power generating machinery, medical and pharmaceutical products, specific organic chemicals, special plastic materials. Examples for medium-tech product groups are paper mill and pulp mill machinery, printing and bookbinding machinery, sound recording and reproducing apparatus and equipment, household type, electrical machinery, photographic and cinematographic supplies, pigments and paints, organic and inorganic chemicals. Within the medium technology group, labor intensive industries (i.e. machines, medical apparatus) seem to be of higher quality than capital intensive medium technology products like motor vehicles or specific chemicals.

- 2) »Physical capital intensive industries«: This group includes product groups which are capital intensive, but at the same time are neither human capital nor resource intensive. Examples are floor coverings, cotton fabrics, iron or steel wire.
- 3) »Labour intensive industries«: This group includes labour intensive products which at the same time are neither human capital intensive nor resource intensive. Examples are leathermanufatures, textiles, footwear, furniture, paper and paperboard, toys, games and sporting goods, which are the kind of products that are usually produced in low-wage countries forcing industrialised countries to qualitative upgrading and product differentiation.
- 4) »Resource intensive industries«: This group includes goods with high inputs of agrarian and mineral resources and according to the intensity of usage are further subdivided into strong and weak resource intensive groups. The latter also include some products groups that are mostly resource intensive but where human capital input is also above average. Examples of prod-

ucts in the resource intensive group are construction materials, glass, textile, yarn, cement, leather etc.

The classification is based on factor intensities across product groups at the 3-digit level of the SITC (Standard International Trade Classification) trade statistic. In a first step total trade in manufactured goods (SITC 5-9) is characterised using the following indicators:

-Human capital intensity: share of scientists, technicians, office-employees, and managerial employees in total employment;

-R&D intensity: share of R&D expenditures in total revenue;

-Capital intensity: gross capital invested per hours worked;

-Labour intensity: hours worked per gross capital invested;

-Scale intensity: employees per production unit;

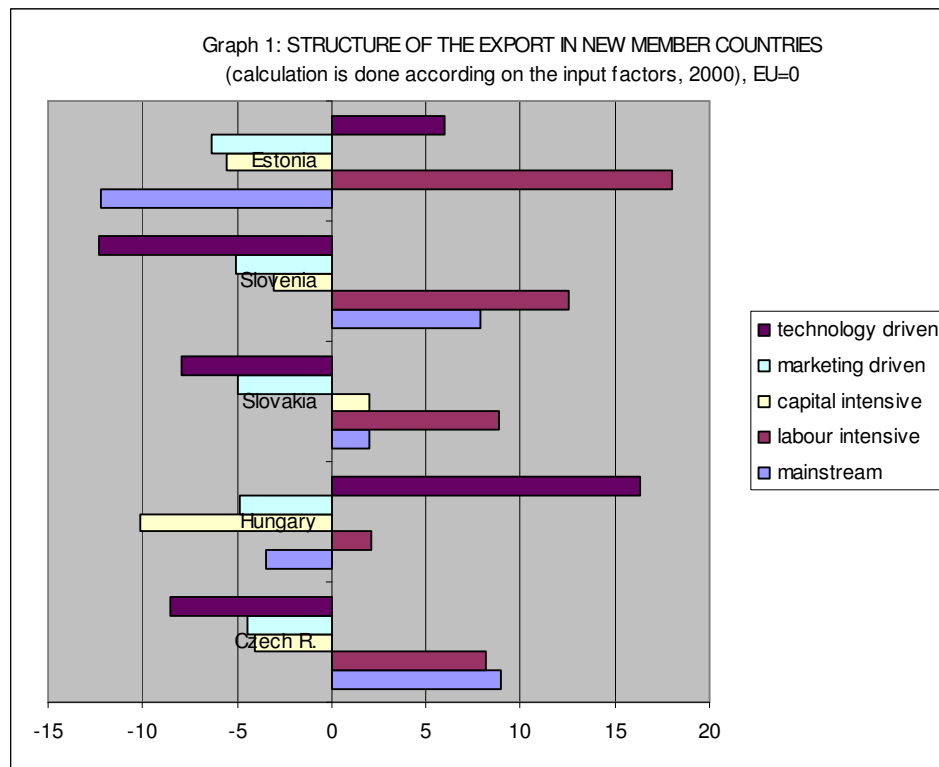
-Resource intensity: share of expenditures on agrarian or mineral raw materials in total revenue;

-Energy intensity: share of energy expenditure in total revenue;

-Environment intensity: share of investments in environmental protection in total investment.

Besides factor intensities, expert judgements were used to distinguish between high-tech and medium-tech production processes within the human capital intensive product groups. For a product group to be assigned one of the above attributes, the input of one factor had to exceed the average value by at least 10 per cent (Wolfmayr-Schnitzer, 1998). We can evaluate the technological position using the Legler/Schulmeister classification of trade into following groups: degree of export specialisation = share of exports of the various technology classes in total exports of manufactured goods; degree of import specialisation = share of imports of the various technology classes in total imports of manufactured goods; revealed comparative

advantage (RCA) indices the relation between the export/import ratio of a specific technology class and the ratio of total exports to imports of manufactured goods; market shares = share of OECD imports from a country in total imports of OECD; export and import unit values. Export or import unit values is calculated as a amount of specific technology class in euros divided by kilograms.

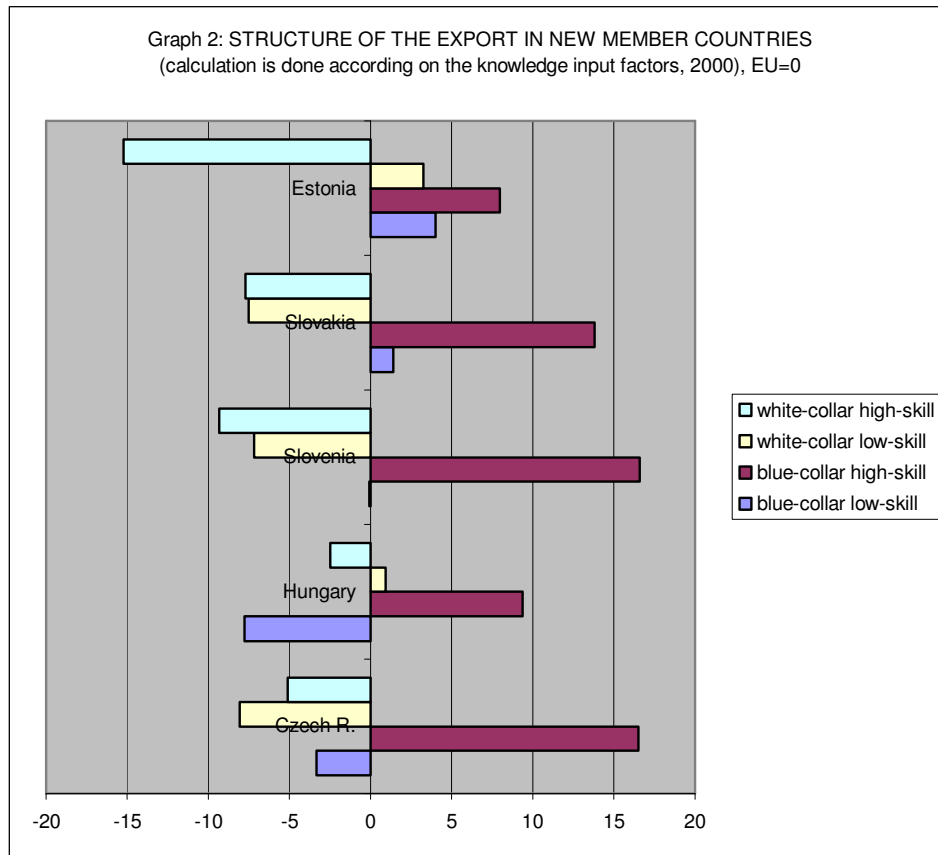


Source: own calculation

In the graph we can see a competitiveness evaluation of CEE countries by typical factor input combination. From the graph can be seen that Estonia rank well by marketing driven industries and also by technology driven industries. Hungary has the best position by technology driven industries. If I observe the technology driven industries,

marketing driven industries and capital intensive industries I realise that Slovenia and Czech R. have negative balance to EU-15 in the year 2000. On the other side CEE countries ranks well by mainstream and by labour intensive industries. According on the export structure all CEE countries laggs behind EU. In Slovenian export strucure can be seen that are labour intensive industries in well position. On the other side Slovenia laggs by capital, marketing and technological intensive industries. Analogous to the first taxonomy introduced above, which related intangible investments in advertising and R&D to the more tangible inputs of physical capital and labour, the important aspect of human resources will be shown the next taxonomy. The data, which have been published by the OECD (1998), are available at 2-digit level of ISIC Rev.2 and distinguish four broad tof occupations, for which shares in total employment can be calculated:

- (i) white-collar high-skill (legislators, senior officials and managers: professionals, technicians and associated professionals);
- (ii) white-collar low-skill (clerks, service workers, shop and sales workers);
- (iii) blue-collar high-skill (skilled agricultural and fishery workers, craft and related trade workers); and finally
- (iv) blue-collar low-skill (plant and machinery operators and assemblers, elementary occupations).



Source: own calculation

This taxonomy shows the human capital especially in the industry. It is important to observe the knowledge level in industrial sector. From the graph can be seen that Hungary has the lowest gap to EU by white-collar high-skill. Czech R. is in better position compaers to Slovenia. Estonia ranks vely in the group white-collar low-skill. According on the export structure compared to EU-15 in year 2000 only Estonia and Hungary have a better position in the group white-collar low-skill.

The survival and competitiveness of firms is determined in product markets. Hence, product market characteristics play a key role in shap-

ing the resource creation, technology development, organisational renewal and internationalisation processes of firms. Both demand and supply side characteristics of markets are important for international competitiveness. For example, technological innovations tend to respond to the existing or potential demand in the market place (Schmookler 1966, Lundvall 1985). On the other hand, supply side factor such as demanding institutional regulations and intensive competitive rivalry have been identified as significant determinants of technological innovation (Porter 1990; OECD 1996). Mainly for these reasons, some economic theoreticians have been intensely critical of the concept of national competitiveness. However, these problems should not lead to the abandonment of the concept. One reason is that the idea behind national competitiveness is intuitively sound and simple: people care about how well they do compared to others, individually as well as collectively as a nation (Fagerberg, 1996). It is the method of comparison that can be modified to make it more robust. Another reason for the relevance of this concept is that there is still need for policy formulation at the macroeconomic level that would increase competitiveness at the microeconomic level. While firms would be the ultimate beneficiaries of such policy, proper analysis and design requires intermediate targets. Therefore, the concept of competitiveness must somehow be extended to a more aggregate level without encountering the aforementioned difficulties. Competitiveness is a concept which links the macroeconomic and microeconomic view of social-economic development. By comparing the European countries the major focus has been on identifying differences at the micro-level (labour market, entrepreneurship, knowledge creation). The microeconomic view is also becoming more important for the SEE region after EU enlargement. The macroeconomic view of competitiveness originates from Ricardo's (1817) comparative advantage theory and Heckscher-Ohlin's (1933) factor proportions theory. Here, the classic postulation is, comparative advantage in price determines the success of a nation in trade. A country produces and exports those goods and services in which it has comparative advantage over others

in terms of price. The Ricardian theory assumes that international differences in the productivity of labour due to differences in production technologies are the reason for cross-country differences in comparative production costs/prices. The Heckscher-Ohlin theory stresses differences in factor endowments (land, capital, labour). Since, many other variables have been found to matter. These include levels of technology (Fagerberg 1988, Rosenthal 1993), capital (Young, 1981, Ray 1995), skill differences of labour (Reich 1990, Strange 1998), entrepreneurship (Lee, Peterson 2000) differences in productive capabilities (Cohen, Zysman 1987, Fagerberg 1988), factor conditions and industry competition (Ohmae 1985, Porter 1990), government policy and expenditure (Nelson, Winter 1985) and globalization and the influence of multinationals (Dunning 1993, Krugman 1994).

3. WEF'S COMPETITIVENESS INDEXES

The popularity of the idea of international competitiveness was further enhanced with the construction of the competitiveness index by the World Economic Forum, which is published in The Global Competitiveness Report. A similar index is prepared by the Institute for Management Development and published in the World Competitiveness Report. However, because of the similarity of the two indices-they had at one time been a single outfit-and the lack of a detailed methodology from the IMD, only the GCR index is discussed. The GCR index is evaluated using three major criteria. The Global Competitiveness Index is broken down into three constituent indexes each representing one of the three pillars: the Macroeconomic Environmental Index (MEI), the Public Institutions Index (PII), and the Technology Index (TI). The WEF invoke several important assumptions in constructing these indexes. First, they separate the countries into two categories: core innovators and non-core innovators. Core innovators are the more technologically advanced countries. According on WEF, technological innovation is more important to the economic growth of coun-

tries at or close to the technological frontier. Therefore they classify countries as core innovators if technological innovation is more critical for growth. To separate core innovators from non-core innovators they count the number of U.S. utility patents (patents of innovation) each country has per capita, for the most recent year. Countries with more than 15 million people are classified as core innovators, while all others are classified as non core. Therefore, to reflect this difference between the core and non core economies, the WEF uses a different formulas to construct the GCI. It is clear that the WEF is attempting to provide advice to governments, business leaders and others about the relative economic growth environment of as many countries as they can. Their aim is to identify those countries with the right macro-economic environment, technology readiness and economic institutions in place that enhance economic growth, while also identifying those countries that fall short of best practice. To that end the calculation of the GCI and its component indexes and sub indexes has merit. However, since these index scores are used to rank countries and create league tables then a closer look at the technical aspects of exactly how the various indexes are constructed must be undertaken.

One way to evaluate the qualitative competitiveness of CEE countries is to illustrate the competitive environment framework with the data for CEE economies and some European countries. The factors in the proposed framework are index measures calculated from perceptual variables collected by executive surveys. In order to calculate rankings of factors of competitive environment framework for selected countries we will use The Standard Deviation Method, which can accurately assess the relative difference between countries performance. The method is also used in both competitiveness reports to calculate overall, factor and sub-factor rankings of competitiveness. The standard deviation for each country will be computed. Finally standardized values were computed for each country by subtracting the country's average from the country's original ranking and then dividing the re-

sult by the standard deviation. Accordingly, we used the following equations:

$$S = \sqrt{\frac{\sum (x - \bar{x})^2}{N}} \quad (STDvalue)_i = \frac{x - \bar{x}}{S}$$

Legend:
 X: original value
 N: number of countries
 S: standard deviation

Growth Competitiveness Index (GCI) is composed of three pillars all of which are widely accepted as being critical to economic growth: the quality of the macroeconomic environment, the state of a country's public institutions, and, given the increasing importance of technology in the development process, a country's technological readiness (WEF, 2005).

Table 1: COMPETITIVE POSITION OF CEE COUNTRIES ACORDING ON GROWTH COMPETITIVENESS INDEX

	Growth Competitive-ness Index	Technology Index	Public In-stitutions Index	Macroeco-nomic Envi-ronment In-dex
Slovenia	33 (4,75)	26 (4,71)	31 (5,28)	39 (4,26)
Hungary	39 (4,56)	29 (4,66)	37 (5,07)	55 (3,95)
Czech R.	40 (4,55)	19 (4,88)	51 (4,56)	41 (4,22)
Slovakia	43 (4,43)	28 (4,67)	49 (4,64)	54 (3,98)
Poland	60 (3,98)	45 (4,19)	80 (3,70)	51 (4,05)
Croatia	61 (3,94)	46 (4,15)	76 (3,86)	59 (3,81)
Romania	63 (3,86)	47 (4,13)	74 (3,94)	71 (3,50)

Source: WEF 2005, The Global Competitiveness Report 2004-2005

Among CEE countries Slovenia ranks highest from the view of Growth Competitiveness Index. On the second place is Hungary and on the third Czech R. Romania ranks on the last place among CEE economies. By technology index rank Czech R (19) and Slovenia (26)

on the top among CEE economies. It is normal that enlargement process have forced the public institutions and macroeconomic environment to become better. Slovenia ranks very high from this criteria. On the other side Romania lags behind other CEE economies, especially from the view of macroeconomic environment. The standard of living is determined by the productivity of a nation's economy, which is measured by the value of goods and services produced per unit of its human capital and natural resources. The central issue in economic development is how to create conditions that will facilitate rapid and sustained productivity growth. Stable political and legal institutions and sound macro-economic policies create the potential for improving national prosperity. But wealth is actually created at the micro-economic level in the ability of firms to create valuable goods and services productively to support high wages and high returns to the capital employed. Political and legal institutions, coupled with macro-economic policies, set the context; yet, prosperity depends on improving a nation's capabilities on the micro-economic level.

Table 2: COMPETITIVE POSITION OF SEE COUNTRIES ACCORDING ON BUSINESS COMPETITIVENESS INDEX

	Business Competitiveness Index	Company operations and strategy ranking	Quality of the national business environment ranking
Slovenia	31	27	33
Hungary	42	48	38
Czech R.	35	31	37
Slovakia	39	41	39
Poland	57	47	64
Croatia	72	72	70
Romania	56	61	57

Source: WEF 2005, The Global Competitiveness Report 2004-2005

Among CEE countries the Slovenia and Czech R. rank highest from the view of Business Competitiveness Index. Romania ranks higher than Poland and Croatia. If we observe the company operations and strategy ranking can be seen that Slovenia ranks on the first place. Croatian's companies rank on the last place. Romanian place (61) is not satisfied compared to other CEE economies. The micro-economic foundations of productivity rest on two inter-related areas: the sophistication with which companies compete, and the quality of the micro-economic business environment. Companies, ultimately, set the level of the national productivity, and their ability to upgrade is inextricably intertwined with the quality of the national business environment. More sophisticated strategies by companies require improved infrastructure, more advanced institutions, higher-skilled people, and better incentives. In addition to the government, many other institutions in an economy also play a role in the economic development. Universities, schools, infrastructure providers, standard-setting agencies, and myriad others contribute to the micro-economic business environment. Such institutions must not just develop and improve, but also become more connected with the economy, and better linked with the private sector. Finally, the private sector itself is not only a consumer of the business environment, but can – and must – play a role in shaping it. Individual firms can take steps such as establishing schools, attracting suppliers, or defining standards that not only benefit themselves, but improve the overall environment for competing. Collective industry bodies, such as trade associations and chambers of commerce, also have important roles to play – in areas such as improving infrastructure and upgrading training institutions – that are often recognised.

4. CONCLUSIONS

In the enlarged European union is interesting to evaluate the competitiveness of CEE countries. Slovenia, Slovakia, Czech R. Romania and Hungary are located in Central Europe. These countries have the same historical backgrounds. The well develop classical infrastrucure and good educational system can be explained through historical reasons. One way to evaluate the qualitative competitiveness of CEE countries is to illustrate competitive environmental frameworks using the data for CEE economies and some European countries. The factors in the proposed framework are index measures calculated from perceptual variables collected by executive surveys. In order to rank factors of competitive environmental frameworks for selected countries we use the Standard Deviation Method, which can accurately assess the relative differences between countries' performances. The method is also used in competitiveness reports to calculate overall, factor and sub-factor rankings of competitiveness. Indexes give as a picture of the competitiveness position of selected group. Transition process and adoption of Acquis Communautaire have increased come differences among CEE countries. Among CEE countries Slovenia ranks highest from the view of Growth Competitiveness Index. On the second place is Hungary and on the third Czech R. Romania ranks on the last place among CEE economies. By technology index rank Czech R (19) and Slovenia (26) on the top among CEE economies. It is normal that enlargement process have forced the public institutions and macro-economic environment to became better. Slovenia ranks very gigh from this criteria. On the other side Romania lags behind other CEE economies, especially from the view of macroeconomic environment. All hypothesis in the article stand.

The competitiveness evaluation of CEE countries by typical factor input combination shows that Estonia rank well by marketing driven industries and also by technology driven industries. Hungary has the best position by technology driven industries. If I observe the tech-

nology driven industries, marketing driven industries and capital intensive industries I realise that Slovenia and Czech R. have negative balance to EU-15. On the other side CEE countries ranks well by mainstream and by labour intensive industries. According on the export structure all CEE countries laggs behind EU. In Slovenian export strucure can be seen that are labour intensive industries in well position. On the other side Slovenia laggs by capital, marketing and technological intensive industries. It is important to observe the knowledge level in industrial sector. Hungary has the lowest gap to EU by white-collar high-skill. Czech R. is in better position compared to Slovenia. Estonia ranks vely in the group white-collar low-skill. According on the export structure compared to EU-15 only Estonia and Hungary have a better position in the group white-collar low-skill. CEE countries are still close form the view of competitiveness evaluation.

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Determinants of Financial Stability

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The subject raises a huge interest in international circles, be it research groups, financial institutions or public decision makers due to market globalization and integration which trigger the risks that are spread from one market to the other through intensive financial flows.

The definition of financial stability is controversial. Therefore we endeavor to select the most prominent views concerning this subject given its importance in modern economies. Further the most important macroeconomic determinants of financial stability are described as well as the requirements to fulfill this objective.

Key words: *financial stability, systemic risk, prudential supervision*

JEL classification: *E*

1. Financial Stability defined

The definition of financial stability is controversial. It generally means the *joint stability of key financial institutions operating within financial markets and the stability of those markets*. For the financial institutions this means that they are sound, i.e. they have sufficient capital to absorb normal and abnormal losses, and have sufficient liquidity to manage operations and volatility.

The concept of financial stability is most often thought of in terms of avoiding financial crises but also managing systemic financial risk. If the latter is managed reasonably well by market participants, through their private risk management and by the authorities through its bank-

ing supervision and market surveillance, then systemic financial crises will most likely not occur.

At this point, it is necessary to define the systemic financial risk. It is the risk that an event will trigger a loss of economic value or confidence in a substantial portion of the financial system that is serious enough to have significant adverse effects on the real economy.

Systemic risk events can be sudden and unexpected, or the likelihood of their occurrence can build up through time in the absence of appropriate policy responses. The adverse real economic effects from systemic problems are generally seen as arising from disruptions to the payment system, to credit flows, and from the destruction of asset values.

Two main assumptions underlie this definition. First, economic shocks may become systemic because of the existence of negative externalities associated with severe disruptions in the financial system. If there were no negative externalities, there would be, arguably, no role for public policy. In all but the most highly concentrated financial systems, systemic risk is normally associated with a contagious loss of value or confidence that spreads to parts of the financial system well beyond the original location of the precipitating shock. In a very highly concentrated financial system the collapse of a single firm or market may be sufficient to qualify as a systemic event. Second, systemic financial events must be very likely to induce undesirable real effects, such as substantial reductions in output and employment, in the absence of appropriate policy responses. The study notes that this definition encompasses much of what is in the literature but it is stricter in two respects. One is that the negative externalities of a systemic event extend into the real economy. They are not confined into the financial system. The second is that this extension into the real economy occurs with relatively high probability. The emphasis on real effects reflects the view that it is the output of real goods and services and the accompanying employment implications that are the primary concern of economic policymakers.

In answering what is financial stability, it is useful to have a working definition of a financial crisis: *A financial crisis is fueled by fears that the means of payment will be unobtainable at any price and, in a fractional reserve banking system leads to a scramble for high powered money.* It is precipitated by actions of the public that suddenly squeeze the reserves of the banking systems...The essence of a financial crisis is that it is short lived, ending with a slackening of the public's demand for additional currency.

Financial stability of an economy depends on two fundamental sets of factors. The first comprises the macroeconomic and structural *conditions in the real economy* bearing on financial decisions and which form the environment within which the financial system operates. The second is the *robustness* of the financial system itself, comprising the financial markets, institutions, and arrangements through which financial transactions are carried out. Major instabilities or distortions in the real economy almost inevitably pose risks to financial stability, however robust the financial system. Nevertheless, a robust financial system can lower the risk that problematic real economic conditions will lead to financial crisis as well as reduce the damage from a crisis if it occurs. Financial stability depends not only on having the requisite institutions and other capabilities; there must also be sufficient political and social consensus supporting the measures needed to establish and maintain that stability.

A robust financial system is essentially one that meets the "test of markets", insofar as it remains stable and efficient under a wide range of market conditions and circumstances. Robust financial systems can take a number of specific forms but all have three basic attributes.

First, a robust system is *flexible* in that it continues to function efficiently in allocating finance in accordance with underlying economic fundamentals under a full range of economic circumstances - in particular when those circumstances are changing rapidly. Secondly, the system is *resilient* in the sense that markets continue to function and payments are carried out reliably and expeditiously in the face of eco-

conomic disturbances. And thirdly, a robust system is *internally stable* in the sense that it does not itself generate major financial shocks, or magnify external shocks, that can lead to financial crisis, for example, when banks continue to lend for the purpose of real estate even when prices have gone beyond economically justifiable levels in the expectation that they will be bailed out if a contraction occurs.

The degree to which a financial system possesses the qualities needed for robustness depends largely on how well it performs three basic functions: maintaining appropriate *incentives* for financial actors; generating the available *information* bearing on financial decisions; and providing the necessary *capabilities* for institutions and individuals to respond effectively to market incentives and utilise information.

Appropriate incentives are essential to ensure that investors, creditors, owners and managers, in the pursuit of their private interests, pay heed to the social consequences of their actions and take necessary precautions in the face of risk. For this to be the case, private actors need to reap the full gains, and bear the full costs and risks, of their financial decisions; and the gains, costs and risks to private actors need to be in line with those available to the economy as a whole. Markets must also be able to exercise adequate discipline, and stakeholders must be able to reward and penalise the managers of financial institutions for their successes and failures.

Timely access to relevant and reliable information is essential for effective financial decisions, as well as for effective market discipline, corporate governance and supervisory oversight. Robust and efficient financial systems possess means for gathering and disseminating all material information needed by lenders and investors to assess the creditworthiness of their counterparties, by stakeholders to monitor the performance of those to whom they have delegated responsibility, and by supervisory authorities to exercise prudential oversight.

To respond effectively to incentives and information, individuals and institutions also need to possess the *capabilities to implement their financial*

decisions. There needs to be a robust infrastructure to ensure that transactions can be carried out reliably and in a timely manner and are enforceable; that information is disseminated adequately; and that there is a sufficient array of markets and financial vehicles to allow actors to allocate their resources effectively among alternative uses and over time, and to diversify risks. In addition, financial actors need to be free from undue regulatory or other legal restrictions on their ability to carry out transactions.

We will further consider key requirements for promoting financial stability. These requirements can be regarded as end-point objectives that efforts to improve financial robustness should seek to attain over time, rather than as a set of characteristics that can be attained immediately or which currently are fully present in any financial system. The discussion begins with conditions in the real economy and then delineates the key elements of a robust financial system under three headings: *infrastructure, market functioning and regulatory and prudential oversight.* Two points concerning the discussion should be emphasised:

1. No single step or narrow group of steps can be sufficient to ensure a robust financial system. Robustness is a function not only of the individual factors themselves but of their interaction; thus improvements in one area typically require complementary measures in other areas if their benefits are to be fully realised.
2. The specific institutional arrangements needed to ensure robustness will change as markets and the economic environment evolve; thus the ability of the financial system, including regulatory and supervisory arrangements, to adapt to economic change is essential to maintaining financial robustness.

2. Prerequisites for a sound financial system

Conditions in the real economy, macroeconomic and structural, provide the basic signals to which the financial system responds. Financial stability depends

critically upon the degree to which these conditions promote the following objectives. The first is to provide as much predictability as possible in economic outcomes by minimising fluctuations in real activity and avoiding unnecessary swings in asset prices and resource allocation. Such predictability reduces, although it cannot entirely eliminate, the risk of extensive financial "mistakes" that lead to financial problems. Predictability requires the avoidance of unsustainable debt loads or financial imbalances whose reversal can lead to sudden large shifts in asset prices and to instability in the real economy. The second objective is to generate appropriate incentives for the allocation of investment resources, across sectors and over time, in a socially efficient manner. And the third is to promote features of the financial system that strengthen its robustness. Macroeconomic and structural conditions are important not only individually, but also because *their effects are mutually reinforcing*. Realisation of the full benefits of stable macroeconomic conditions requires sound structural conditions; and certain structural imperfections can greatly magnify the financial risks arising from unstable macroeconomic conditions.

a. Macroeconomic requirements

The following macroeconomic requirements are crucial for the maintenance of financial stability:

1. Macroeconomic policies should seek sustainable growth in line with the economy's potential, and avoid "stop and go" growth since it creates widespread uncertainty and risks of pervasive financial reverses.
2. Achieving and maintaining price stability is of equal importance to sustain incentives to enter into long-term contracts and to minimise distortions and the uncertainty about relative prices fostered by inflationary environments.
3. Sound public finances are essential: public deficit and debt levels should be sustainable and moderate. Public debt, especially that held externally, must be adequately diversified in terms of currency, maturity and the range of holders. Government pension systems and other

public programmes involving future commitments need to be adequately funded and consistent with the economy's capacity to meet the commitments.

3. There must be an adequate level of national saving, private and public, to finance domestic investment needs without unsustainable reliance on foreign borrowing.

4. Macroeconomic policy instruments must be adequate and consistent with the exchange rate regime: monetary authorities need to be free to pursue price stability as their overriding objective; and fiscal authorities must have the capability to control public expenditures and collect adequate revenues.

Given that financial decisions involve commitments extending into the future, *financial stability depends not only upon the present or recent effectiveness of macroeconomic policies but also upon their future credibility*. A high degree of policy credibility helps to minimise volatility in financial market prices and makes it more likely that changes in those prices will be stabilising for the economy as a whole. Credibility is largely derived from past policy performance over a substantial period - which increases the premium on the pursuit of sound policies in the present. And, especially as financial markets develop and become more sophisticated, credibility depends increasingly upon the clarity, transparency and internal consistency of the policy commitments of public authorities.

b. Structural requirements in the real economy

Structural policies should seek to ensure that relative prices are in line with economic fundamentals so that they provide proper financial incentives; and that structural conditions promote the efficient and sustainable allocation of real and financial resources. Sound structural conditions promote the smooth adjustment of prices and quantities to changing economic conditions, and reduce risks that asset values will be impaired by sudden shifts of relative prices that have become misaligned in relation to their long-term fundamental determinants.

Important ingredients of sound structural conditions include:

1. Tax policies that minimise distortions to incentives; tax provisions whose distortionary effects are magnified by inflation should be avoided; tax regimes should be stable and predictable.
2. Efficient, competitive and flexible markets - for products and productive factors such as land, labour and other basic resources - that affect financial incentives. Structural policies affecting the financial sector, further discussed need to ensure its efficient operation, stability and robustness.

c. Institutional infrastructure of financial markets

The availability of information necessary for sound financial decisions, the ability to respond to incentives and the capacity to implement financial transactions efficiently all depend upon the quality of a number of infrastructure building blocks that support effective market functioning. These include the *legal and judicial framework* governing financial markets and operations, the *accounting systems* used to gather and disseminate information, the *payment systems* for executing transactions, and the *infrastructure features of the markets themselves*.

The basic functions of the *legal/judicial framework* in supporting the financial system are:

1. to establish clearly the rights, responsibilities and liabilities of the parties to financial transactions;
2. to establish codes that support market forces in maintaining appropriate incentives and adequate information;
3. to provide means to enforce legal obligations and claims efficiently.

In order to accomplish these aims, the legal framework needs to include adequate contract, corporate, bankruptcy and private property laws. A basic requirement of any legal code is up-to-date contract law that clearly defines the contractual rights and responsibilities of all agents involved in loans and in the purchase, sale and holding of the

full range of available financial instruments. Among the legal provisions required are those governing obligations to meet contractual payments, the definition and consequences of non-payment, requirements entailed by covenants and other conditions placed on the borrower, and custody of collateral. Responsibilities and liabilities of financial agents, stakeholders and managers of financial institutions need to be clearly defined, so that they are held accountable for their conduct. As far as possible, legal provisions governing financial activity need to be "rule-based" and transparent. For example, conditions governing the exercise of contingent provisions, such as call options, and the taking possession of collateral, need to be objective so that they can be readily identified by all parties. Legal provisions should also be formulated in a sufficiently flexible fashion to allow their extension to new instruments and activities as they emerge - while recognising that changes in laws will be necessary when more fundamental market changes occur.

Since individual actors often have an incentive to withhold private information, legal codes need to mandate disclosure of facts directly material to counterparties, stakeholders and other interested parties if effective market discipline is to be maintained. Other activities that take undue advantage of information disparities or which abuse fiduciary responsibilities, such as self-dealing or insider trading also need to be legally discouraged.

Of particular importance to preserving appropriate incentives are standards governing the entry of financial firms together with bankruptcy codes and other provisions relating to exit. Well-designed bankruptcy codes reduce uncertainty by specifying *ex ante* rules governing the distribution of unpaid obligations in the event of failure, and provide a necessary "breathing space" to make provision for an orderly disposition of the failing entity, or to allow the continued operation of an entity whose value as a going concern exceeds its break-up value. It is very important that such provisions maintain stakeholders' liability, up to the limit of their original commitment, for losses from failing

institutions as well as management accountability so that moral hazard incentives are contained. Codes should be such that bankruptcy is seen as a last resort by institutions in financial difficulties to avoid undermining the fundamental principle that debts must be repaid on time and in full. To balance these considerations effectively, bankruptcy authorities need to have adequate legal and administrative authority to replace managements, to reorganise failing institutions, and to develop and, if necessary, impose formulas for distributing assets.

The effectiveness of the legal framework also depends critically upon the quality of enforcement of its provisions. Judicial remedies in the event of non-compliance with contracts need to be efficient and expeditious: judicial procedures should not be so costly that they discourage companies from acting to enforce their contracts. It is particularly important that remedies are obtainable in a time-frame that is relevant to the financial transaction involved: for example, unless creditors are able to gain possession of collateral rapidly in the event of non-payment, or to take action quickly when covenants are violated, the provisions are effectively voided in economic terms. Legal procedures for enforcement also need to be objective and honest so that outcomes of disputes are as predictable as possible on the basis of objective criteria. There should be laws against illicit financial activities, in particular money laundering, and they should be vigorously enforced since such activities, by undermining the reputation of individual financial entities, can impair confidence in the financial system as a whole.

Two other specific priorities are improvements in the *transparency and efficiency of the judicial mechanisms* to enforce financial agreements; and ensuring that *effective means exist to take possession of collateral*. Difficulties encountered in many emerging markets in obtaining reliable remedies in case of non-compliance (because of undue delays, overly convoluted administrative procedures and the inability to predict how applicable laws will be interpreted in practice) were cited by many of the respondents to surveys of participants in major financial centres. Improve-

ments in this area would help particularly in improving emerging market economies' access to external financial markets and in encouraging the transfer of skills and financial technology via direct investment. All economies periodically face the task of *revising and updating legal codes to reflect new market realities*. Transition economies face a particularly great challenge in developing legal codes suitable to a market environment, given their heritage of extensive state involvement in economic decisions. In this respect, frameworks based on industrial country models have proved quite useful as a starting-point but must still be adapted to the particular financial systems of transition economies and altered as those systems evolve.

Accounting systems are central to the provision of the information needed by the creditors, borrowers, owners, managers and others with an actual or potential stake in an enterprise to make reasonable assessments of the effectiveness of the enterprise's operations and to assess its future prospects. High-quality accounting systems are essential to ensure the transparency of operations needed for effective internal governance and market discipline. Effective accounting systems embody four basic quality standards.

First, the information provided is numerically and factually *accurate*; secondly, it is *relevant and transparent* in that individual items correspond correctly to the underlying condition being reported; thirdly, the information is *comprehensive* in covering all material activities and aspects of an enterprise's operations that bear on its present and future financial condition; and fourthly, the information needs to be sufficiently *timely and regularly provided* to be of use when decisions are made.

A more general principle is that accounting measures should provide a realistic picture of the *true economic gains and losses*. Methods used to value assets need to take realistic account of their likely value when liquidated or redeemed, in the light of the portfolio strategies of the institution as well as unforeseen contingencies it may encounter. Valuation at historical cost of loans or other assets, for which there is

no satisfactory organised market, on the condition that adequate provisions are made for non-performance or losses, can provide a reasonable method of accounting for the true economic value of assets that are held to maturity. On the other hand, marking marketable assets to market value generally provides a more reliable indication of their true economic value, but only if the markets are sufficiently developed and efficient to provide reliable guides as to prospective asset-sale prices.

Essential elements of accounting procedures applying to banking and other financial institutions are standards governing:

1. Classification and reporting of asset quality, including realistic valuation and strict criteria for recognising bad loans;
2. Timely and prudent procedures for provisioning and strict quality standards for the components of capital;
3. Accurate measurement and reporting of loan concentrations, including systems to detect excessive lending to related parties or over-concentrations in particular sectors or instruments;
4. Relevant measures of profitability and other aggregate indicators of the overall financial position;
5. Effective systems to assess individual risks as well as risks to the aggregate portfolio under various contingencies;
6. Consolidated reporting including all relevant affiliated entities whose condition directly affects the financial position of the parent;
7. Adequate reporting of contingent and below-the-line liabilities, such as unfunded pension liabilities and guarantees for affiliates.

These procedures and rules are essential to avoid the concealing of serious asset quality or other financial problems in financial institutions from supervisors and stakeholders. *Auditing mechanisms* are essential to ensure that accounting norms are effectively applied and maintained and to monitor the quality of internal control procedures. Both internal and external audits are vital complements to assessment of finan-

cial institutions by supervisory authorities. Internal audits on an ongoing basis enable problems to be recognised before they are able to impair the financial soundness of an institution. External audits on the basis of internationally acceptable standards by independent qualified private entities are important in ensuring the objectivity and integrity of internal control procedures and the accuracy and comprehensiveness of information disclosed to external parties. To ensure their objectivity and credibility, external auditors need to be legally accountable for the competence and integrity of their examinations. There should be comprehensive laws setting out the responsibilities and obligations of external auditors, and independent auditing should be required at least for public companies and licensed financial institutions. However, internal management bears the first and primary responsibility for ensuring that internal audits are effectively conducted and that information disclosed to external auditors and the public is adequate.

The *development* of accounting standards so as to provide accurate, timely and internationally comparable information is a key priority for improving the robustness of financial systems in emerging market economies, particularly given the role that deficiencies in accounting systems have played in past banking crises.¹⁷ It is very important that national accounting standards be of high quality and be rigorously interpreted and applied. Harmonisation of private accounting standards with those employed by supervisors is also important in order to reduce the costs to private institutions of complying with regulatory/supervisory requirements.

In many emerging economies, auditors, management and supervisory authorities face considerable difficulties in adequately measuring the value of individual instruments and

Therefore of an institution's portfolio as a whole. These difficulties have considerably hampered the ability of managements to assess adequately their institutions' financial status and to make changes in investment priorities when needed; also hampered are market discipline

and the ability of regulators to recognise developing problems before they become serious. While due partly to deficiencies in accounting standards, this difficulty is aggravated by underdeveloped markets, which make it hard to predict liquidation values; and where markets are better developed, by a lack of price data on which to base assessments of loan and other asset values.

This problem also raises a broader issue *about gaps and deficiencies in publicly available data*, particularly from national authorities, on aggregate financial indicators, conditions in the real economy and government policies. A lack of such basic data, for example timely figures on the international reserves held by the government, has been an important factor limiting the ability of stakeholders and other interested parties, in particular foreign investors and official institutions, to effectively monitor the economic and financial condition of countries that are major international borrowers.

3. Regulation and supervision of financial systems

Official oversight of the financial system encompasses financial regulation, including the formulation and enforcement of rules and standards governing financial behaviour as well as the ongoing supervision of individual institutions. Financial regulation and supervision play an essential role in fostering financial robustness. They should seek to support and enhance market functioning, rather than to displace it, by establishing basic "rules of the game" and seeing that they are observed. Effective and adaptable regulatory/supervisory structures are critical in all economies. Special vigilance and skill are needed by the regulatory/supervisory authorities to contain the risks arising when the financial system is undergoing rapid and extensive change.

A fundamental guiding principle in the design of all regulatory/supervisory arrangements is that they should seek to support and enhance market functioning, rather than to displace markets. Where financial systems are less developed, a key objective of policy is to reduce the need for regulation in the future by improving the quality of

private market forces. The historical experience of industrial countries suggests that the emphasis in regulatory and supervisory approaches shifts as markets liberalise from explicit limits or other rules towards primary reliance on guidelines, supervisory assessments and incentives for sound business behaviour on the part of owners, stakeholders and management.

Apart from the specific responsibilities and objectives noted below, regulatory/supervisory authorities collectively need to pursue the following broader objectives:

1. Define clearly the types of institutions subject to regulation and oversight along with the jurisdiction of each regulatory/supervisory agency for those institutions.
2. Promote the reliability, effectiveness and integrity of the market infrastructure, in particular payments and transactions systems.
3. Foster efficient operation and competition in the financial system. The specific forms taken by regulation and supervision in any particular country are necessarily shaped by individual circumstances, particularly the state of the key features described in earlier sections. Typically, there will be several regulatory/supervisory agencies, with authorities responsible for banks institutionally distinct from those responsible for other major classes of financial institution or for securities markets.

Banking and other authorities charged with overseeing financial institutions have three major areas of responsibility: licensing of new entrants and authorisation for new or expanded activities by existing entities; ongoing supervision of the financial institutions; and remedial correction of problems arising in institutions that are failing, or at risk of failing. To carry out its mandate effectively, each official agency must have powers and responsibilities that are clearly defined and of sufficient scope to accomplish its mission, appropriate standards and enforcement mechanisms, and adequate human and other resources.

There needs to be close coordination and exchange of necessary information among banking, securities market and other regulatory/supervisory authorities, with suitable protection of such information where appropriate.

A clear framework defining responsibilities, objectives and operational independence is an essential foundation for effective regulation and supervision. Ensuring, and if necessary strengthening, the independence of supervisors and regulators is especially important when there has been extensive government involvement in the financial system or when financial institutions are closely allied to large and politically influential commercial interests. At the same time, supervisors and regulators need to report regularly on the general considerations shaping their policies if they are to maintain their credibility with the market and the general public.

In order for supervisors and regulators to exercise their powers and responsibilities in a coherent fashion, *they need a comprehensive set of prudential norms and standards.* In the absence of such criteria, supervision is likely to be haphazard, idiosyncratic and more vulnerable to pressures for exceptions and exemptions. The norms and standards need to be objective, internally consistent, transparent and well-understood by those to whom they are applied; such norms need to clearly define behaviour that is not permitted, as well as the nature and treatment of exceptional or "suspect" conditions, such as exposures that, while permissible, carry special risk or otherwise warrant attention. Regulatory norms and standards must be relevant and consistent with prevailing conditions in the country in which they are applied. However *it is highly desirable that they be of high quality and shaped by certain core principles* for at least four reasons: first, to assure market participants, including foreign stakeholders, that sound financial practices are being applied, thereby increasing market confidence in the country's overall financial health; secondly, to help promote a level playing-field and fair competition among institutions of a similar type; thirdly, to prevent countries adhering to rigorous financial practices from being unduly penalised by "regulatory" competition from jurisdictions with overly lax regula-

tory standards; and fourthly, to make effective use of the experience and expertise of the international supervisory community in formulating the principles. Norms and standards can play this role only if effective means exist for their *enforcement*. All supervisory authorities need to have access to comprehensive, consistent, reliable and timely information on the activities of the financial institutions they oversee, including those of home or foreign affiliates. Supervisors should have sufficient independence and authority to be able to impose penalties if prudential regulations are not met. Depending on the institutions supervised, possible penalties include: fines; the removal of management in cases of unsafe or unsound banking practices; and constraints on the institution's permitted activities, including, in extreme cases, closure.

The formulation of policies and standards and their implementation and enforcement also require that regulatory/supervisory authorities *have adequate financial and human resources*. Financial crises (including those of the US savings and loan industry) have not been prevented in part because supervisors were either too understaffed or otherwise unable to detect problems arising from the changing strategies of the financial institutions.

Supervisors need to understand the full range of activities undertaken by the institutions they oversee and their knowledge and skills need to be periodically updated to keep abreast of market developments, such as the use of novel instruments and complex portfolio strategies. Supervisors need to have the means to collect, review and analyse supervisory and financial reports from banks on a solo and consolidated basis.

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The Future of European Constitution -Treaty of Lisbon

Ovidiu – Horia Maican

Europe has changed, the world has changed. The 21st century brings new challenges and new opportunities. The interaction of economies and peoples worldwide – whether by communication, trade, migration, shared security, concerns or cultural exchange – is in constant evolution.

In such a globalised world, Europe needs to be competitive to secure economic growth and more and better jobs, in order to achieve an overall sustainable development.

Climate change calls for a response that must be both global and local.

Demographic change has shifted some of the old certainties about the patterns of how society works.

New security threats call for new strategies and policies.

In all these areas, Europe needs to be equipped for change. Tomorrow's prosperity requires new skills, new ways of working, and political, economic and social reforms.

Key words: *Constitution, European integration, Federalism, Future, Romania*

I. INTRODUCTION

The problem of the European Constitution is increasing in importance and relevance in many member states.¹

¹ Sebastian Kurpas, Marco Incerti, Jutus Schonlau, Julia De Clerck – Sachsse – Update on the Ratification Debates. What Prospects for the European Constitution Treaty?, EPIN (European Policy Institutes Network) Working Paper, no. 13/2005, page 24.

In this context, there is an evident difference between the member states in which referendums have been developed and the ones that chose the way of the parliamentary ratification. While in the latest states the debate on national level had a limited character, in the states that chose the referendum, the national governments had to explain the contents and the significances of the European text.

It is also important the way in which the different specific aspects are perceived in the national debates.

Thus, the provisions with economic character of the 3rd part of the Constitution project draw the attention on the absence of the social protection in France, but has a contrary effect over the state of economies in other states, such as Great Britain.¹

In the same time, the constitutional text continues to be opposed to the national maximalist requests (claims), and the European dimension of the problem is most of the times ignored. Especially, the debates developed in France on different occasions hide the fact that the constitutional text is a synthesis of many national and political interests.²

In all states a limited influence of the community institutions or actors is observed. With some exceptions, the community institutions are almost absent from the debates. As a result, the role of the national parties and politicians from each community state may be considered crucial.

We must take into consideration the fact that the debate on European level is not cumbered only by opponents of the Constitution project. For example, the former French president Jacques Chirac set up for a defender of the national French interests in the case of the Directive of Services (Bolkenstein Directive). Initially he has been (at least declaratory) an adept of this community regulation.³

¹ Sebastian Kurpas, Marco Incerti, Jutus Schonlau, Julia De Clerck – Sachsse – Op cit, page 24.

² Sebastian Kurpas, Marco Incerti, Jutus Schonlau, Julia De Clerck – Sachsse – Op cit, page 25.

³ Sebastian Kurpas, Marco Incerti, Jutus Schonlau, Julia De Clerck – Sachsse – Op cit, page 25.

The adepts (representatives) of the positive (affirmative) vote will have to prove the European common (usual) impact (significance) of the Constitution, as a national strategy of the type “we against them” will affect not only the process of adopting the European Constitution, but also the entire integration process.

In the light of the debates in France, comes out the fact that defending the Constitution against the national maximalist positions will not be possible unless the citizens will understand the fact that the constitutional text represents the result of a necessary compromise between 27 different states (with the participation of the civil society, the European institutions, the national parliaments and the candidate states).¹

The European integration makes necessary a debate on the European level, as the negative vote expressed in a country has effects on the entire European Union. In the case of non-ratification of the Constitution, things will probably get stuck on the level of the Nyssa Treaty. Probably some elements of the Constitution will be saved, but the coherence will be lost and we will reach a Byzantine structure. This is the alternative that will fuel the Euro-skepticism more than the Constitution did.²

The German chancellor Angela Merkel became the target of powerful critics after expressing some remarks regarding the mentioning of Christianity in the preamble of the Treaty.

One can say that there are many divergent points of view and interests. The Vatican wishes the mentioning of God, the French wished a permanent place in the European Constitution and the elimination of provisions regarding the competition (which actually happened in 2007), the British wanted to eliminate the Book of Fundamental Rights and the function of Minister of Foreign Affairs (and they succeeded), the Polish are the adepts of returning to the qualified majority voting system provided in the Nyssa Treaty and mentioning the Chris-

¹ Sebastian Kurpas, Marco Incerti, Jutus Schonlau, Julia De Clerck – Sachsse – Op cit, page 25.

² Sebastian Kurpas, Marco Incerti, Jutus Schonlau, Julia De Clerck – Sachsse – Op cit, page 25.

tianity, and other small states want renegotiations regarding the presidency of the Council.¹

Despite uncertain imperfections, there is a principle political agreement on the key-articles (fundamental, basic) regarding the values, principles, purposes, competences, instruments and decisional procedures (Part I), as well as on the Charter of Fundamental Rights (Part II).

Germany, who ratified the Constitution project, may act as spokesman of its adepts.

One may add the fact that in Great Britain, where from the practical point of view nobody debated or explained the Constitution project, the Parliament does not dispose, from the substantiated point of view of its relative merits.

The states which have not yet pronounced themselves regarding the document of 2004 (Bulgaria, Czech Republic, Denmark, Ireland, Great Britain, Poland, Portugal, Romania or Sweden) will find themselves in advantageous positions in the event of eventual renegotiations.²

One of the critics brought to the project in 2004 (especially by the French left), is that according to which the constituting of community treaties will make the performance of any modifications in the future more difficult. This imposes in the course of eventual renegotiations the elaboration of more facile procedures of constitutional review.

Concomitantly, it is necessary to settle a hierarchy between the different parts of the Treaty, in the meaning that Part III (including the main community politics and administrative, budgetary and legislative detailed procedures) to be subsidiary to Part I.

Part IV should be modified in the meaning in the meaning of admitting any amendments to Part III, which would not grant new compe-

¹ Andrew Duff-Op. cit, page 57.

² Andrew Duff-Op. cit, page 58.

tences to the Union, amendments which require the vote of four fifths of the member states, representing minimum two thirds of the European Union's population, states that would have terminated the process of ratification.

Regarding the substance of the European Constitution project, there are five action fields that must be improved (modernized), thus directly addressing to the sources of discontent of European citizens (popular).¹

- 1) the Union's economic governance must be strengthened, especially in the Euro area. The constitutional project must also mention the objectives of the Lisbon Agenda, relatively to the modeling of community economic policy to answer the requests of globalization. The states of Euro area must constitute in a group (thing which was performed in 2007), functioning according to the improved rules of strengthened cooperation, provided in the Constitution project. The European Commission needs more powers to be able to propose changes to the national budgetary policies and the policies for the increase of the degree of labor force occupancy.²
- 2) It is necessary to define the common architecture of the European social model, which finds solutions to the current problems of equity, efficiency and degree of labor force occupancy. The phrase "unity in diversity" must be correlated to the observance of the social dimension of unique market. A new Declaration of Solidarity should include all the social policy provisions of the new Constitutional Treaty, in order to facilitate the interpretations. The member states which desire to go forward in this field may mutually agree a Social Union Protocol, also according to the new rules of strengthened cooperation.³

¹ Andrew Duff-Op. cit, page 58.

² Andrew Duff-Op. cit, page 59.

³ Andrew Duff-Op. cit, page 59.

- 3) It is imposed the actualization of policy in the field of environment, in the present considered an accessory policy of the unique market and axed on the pollution control. The fight against the climate changes must be the imperative to which all common policies will conform to. This reform will open the perspective of remodeling the policies in the agricultural and fishing fields. The common policy in the field of electricity will be able to become a feature of a reformed Union, including here the objectives of conserving the energy and other new sources of energy, as well as the perfecting of security and diversity of supply sources (objective reached in 2007 as well).¹
- 4) The inclusion of a new chapter in Part III, which refers to the policy of extending the European Union is imposed. In this context, a rigorous process of adhesion of each new state must be provided, including pre-adhesion agreements, reporting, saving clauses and transition arrangements (agreements), absent in this moment. The concept of vicinity policy, summarily provided in Part I, must also be included here. The creation of a new category of associated members is imposed, in order to answer the present debates about the capacity of absorbing the privileged funds and partnerships.²
- 5) A reviewed financial system, regarding the incomes (the reduction requested by the British) as well as the expenses (the Common Agricultural Policy), will be negotiated in 2008 – 2009. The new system will have to imbue the belief that the community budget exists for the redistribution of the welfare between the rich states and the poor ones, that it may be verified and that it may allow the Union to direct the expenses depending on its political priorities (such as the future extensions). The purpose is to create a more equitable and more transparent

¹ Andrew Duff-Op. cit, page 59.

² Andrew Duff-Op. cit, page 59.

system than the present one (improvised and which allows complicated and mercantile arrangements).¹

The modifications brought to Part III in these five fields have as purpose the strengthening of the financial discipline, the modernization of the economic and social policies, the analysis of insecurity generated by climate changes and the better informing of the citizens about the enlargement (extension) of the European Union.

The delicate problem of the referendum is still to be discussed.²

On one side, those parties that manifested their populist tendencies in the direction of the referendum will show less enthusiasm in repeating this process.

On the other side, those political governments and parties that did not succeed in mobilizing the electorate or even did not wish to mobilize it may block in one sole state the entire European constitutional process.

A viable alternative of solving the dilemma could be the ratification by all the national parliaments, followed by a popular referendum at the European level, in order to confirm or infirm the popular support for the European Constitution project.

The French president Nicolas Sarkozy considers that a mini-treaty containing only the problem of the powers and the one of the institutions is most likely to obtain the popular support in states like France, Great Britain, Netherlands.³

After all probabilities, the French and Netherlander citizens will not accept a technocratic fix. Moreover, the current European constitutional project (a more or less inspired coy of the Nyssa Treaty), which ceases the national sovereignty to foreign forums will not obtain the

¹ Andrew Duff-Op. cit, page 59.

² Andrew Duff-Op. cit, page 61.

³ Andrew Duff-Op. cit, page 61.

vote of the Chamber of Commons of Great Britain and moreover, will not receive the British popular vote.

The British Prime Minister Gordon Brown is anxious to present the renegotiation of the constitutional treaty as a progress regarding the mandate of his predecessor, Tony Blair. This means that the institutional aspect (package) must include a reform of the common community policies, also considering the British grievances, such as the reform of common agricultural policy, structural economic changes and more equitable financial arrangements.¹

With the spring of 2005, there were few ideas related to the answer which can be given to the crises determined by the French and Netherlander referendums.²

This problem is a very complex one. On the other side, the idea of new referendums is not agreed either by France, or by Netherlands, and on the other side, those states that already ratified the Constitution project cannot be easily convinced to enter a new series of negotiations.

The mechanism of reforming the community treaties is very conservative. It has not been changed since the beginning of the European construction process, although some states raised on the way the problem of democratic control.

The conservatism is easy to explain through the desire of the European governments to hold control over this process, in the meaning that the European integration must not take a direction contrary to their desires.

The section regarding the eventual future reviews of the Constitutional Treaty contains provisions of a maximum prudence, providing the re-

¹ Andrew Duff-Op. cit, page 61.

² Renaud Dehousse-Can the European institutions still be reformed? European Policy Center (EPC), Challenge Europe, Issue 16, February 2007, page 63.

quest of humanity for signing, as well as for the ratification of any amendments of the new fundamental charter.¹

Although the treaties have been reformed for four times in less than two decades, in the last five years a consensus for the need of “re-forming the reform process” has appeared.

Already since the Amsterdam Treaty in 1997, critics regarding disordered nature of the intergovernmental negotiations have been expressed, where crucial decisions are adopted in a hurry, in the last moment. The semi-failures of the Amsterdam Treaty and Nysa Treaty led to the settlement of new more opened (transparent) procedures and the creation of a new structure, the Convention for Europe’s Future, which elaborated the European Constitution project.

In the context of an Europe formed of 27 states, where the agreement of each member is required for the smallest reform, there is a great risk of additional problems appearing in the ratification stage.

If we accept that Europe did not reach the end of its institutional evolution, we must surpass humanity’s problem, in order for things to evolve.

As mentioned before, the general review procedure provided in the community treaties is of the outmost rigidity. Any amendment must be adopted through an agreement of will of the representatives of the member states’ governments, reunited within a diplomatic conference. The respective amendment comes into force after it is ratified by all states according to their constitutional norms.²

This procedure involves more difficulties.

Its diplomatic nature does not make it a transparency model. Its decentralized nature (each member state being allowed to present proposals) may sometimes lead to disjoint (parallel) negotiations, espe-

¹ Renaud Dehousse – Op. cit, page 63.

² Renaud Dehousse – Op. cit, page 64.

cially in the final phases of the conferences. The lack of a powerful management is felt, especially if the number of participants grows.

Generally, the spikiest problems are occasions by the meetings between the Ministers of Foreign Affairs, state chiefs and governments, which sometimes lead to a deadlock.

The problem is amplified (exacerbated) by the double unanimity required in order to conclude an intergovernmental conference. Each delegation has the right to veto at the end of the works. One can also appeal to the more subtle method of suggesting that, in the lack of certain concessions for certain special questions, the final document may be rejected in the national parliament or through people's referendum.¹

Thus one may fall in "the trap of common decision" (the pursuit and negotiation of own interests, each state wishing to maximize their own advantages, the general interest not being important anymore).

The settlement of an European Convention will bring a few significant changes to this system (more participants in the reform process, such as the members of the European Parliament or members of the national parliaments, as well as a greater transparency of the debates, which are opened for the public).

These changes of the rules allow the Convention to reach a compromise on the unsolved problems of the past, such as the dissolution of the pillar structure, simplification of the treaties and legal character of the Union.²

However, it is wrong to say that this innovation will make a decisive difference in the balance of power in the context of the review procedure. The constraint of double unanimity still exists. Each of them knows that a Convention is followed by an intergovernmental conference, where the member states may express their objections to the text

¹ Renaud Dehousse – Op. cit, page 65.

² Renaud Dehousse – Op. cit, page 65.

project and where they obtain additional concessions. The most delicate stages of the debate are shadowed by the threat of final compromise, which impel the participants to moderate their claims. On other words, the member states keep control over the final compromise.

The failure of Constitution is a confirmation of the fact that we deal with structural problems.

A negative result of the referendum was expected in at least one state. The surprise was the negative result in two founding member states, sooner than in one Euro-skeptical state by definition (Great Britain), or in two new states (Czech Republic and Poland).¹

In a system involving multiple negotiation stages, with 27 member states (possibly 30 in the future), the chances of failure are greater. Moreover, the number of institutions with the right to veto is greater than the number of the member states. For example, a national parliament may refuse the ratification of a treaty signed by its own government, as the case of the rejection in 1954 by the French National Assembly of the European Community Treaty for Defense.

Unless this difficulty is solved, any significant reforms will be impossible.

Right before the beginning of the works on the Convention, opinions according to which, with the growth of the number of member states, is necessary to review the request of double unanimity provided by the treaties (unanimity within the Convention or the Conference and the unanimity of ratification by all member states) have been expressed.

The problem of rejection is not new. The Maastricht Treaty has been rejected by the Danish (the rejection by the French has also been very probable, considering the results of the people's referendum), and the Nyssa Treaty by the Irish. According to some opinions, these precedents should have been taken into consideration by adopting some

¹ Renaud Dehousse – Op. cit, page 65.

protocols or declarations, which would answer to the ones that voted No, before the voting of a new text.

The conditions are radically different in the case of the Constitution project. The reasons that formed the basis of the French and Netherlander negative vote are heterogeneous and it is difficult to foresee that a formal declaration could answer them entirely. Besides these, these two founding states have no reasons of concern regarding the risk of exclusion, being difficult to imagine that Europe can be build without them.

The European Union reached the limits of the current reform mechanisms. If it wishes to evolve, it will have to give up the rule of unanimity. Many international organizations (starting with the United Nations) already use reviewed procedure of qualified majority.¹

The unanimity had sense in an union of six states, but in one of 27 states, it will most likely reach the paralysis of the decision.

Besides the political obstacles, there is a legal one as well, as the existing treaties may be amended only through unanimity.

This question (problem) occupied a central place in the elaboration process of the European Constitution project within the Convention (“Penelope” project).²

In order to avoid a deadlock, the Commission proposed an innovating solution, giving each member state the possibility to opt “between the continuation of participating to the Union, now based on a Constitution and the withdrawal from the Union, in order to adopt a special status, within which it will not loose anything in comparison to the current situation, as it will benefit from a large extension of the current arrangements (agreements)”.

The legal legitimacy of this solution is based on two elements. On one side, it offers all the guarantees to the recalcitrant states by keeping

¹ Renaud Dehousse – Op. cit, page 66.

² Renaud Dehousse – Op. cit, page 67.

their already settled (earned) rights, and on the other side, the member states must unanimously approve this procedure of amending the Treaty.

There are a few advantages of this ingenious solution.¹

First of all, the question of conditions in which the new treaty would come into force must have been approached since the beginning of the negotiations (affirmation proved by the current stage of the Constitution project).

The Penelope document wanted to appease (conciliate) the need of reforms with the respect for the law. This was a much more optimistic supposition, as it was expected that the member states would give up the rule of unanimity. The thing that made the proposal powerful from the legal point of view (fulfilling the conditions of the international law), made it weak from the political point of view.

The moderate (cold) reactions for this project are not exactly surprising. The unanimity is in the advantage of the status-quo adepts and who accept the failure to any tries of reform. Even the most pro-European states are moderated in ceasing their right to veto. Under these conditions, except a crisis situation, it is difficult to believe that the governments will give up the power the unanimity gives them.

In order to make this radical change possible, another way must be adopted. This refers to the creation of a new legal structure within the European Union. In this situation, the unanimous will agreement is no longer necessary. The signatories of the new text can provide less strict conditions for the coming into force, and the one that cannot ratify the new treaty may continue to be members of the European Union.

From the legal point of view, this solution is probably less elegant than the precedent one. It will compulsorily make thing more complex, at

¹ Renaud Dehousse – Op. cit, page 67.

least in the initial phase, which will lead to the creation of new structures within the already existing ones.

Besides these, a new agreement cannot, in principle, affect the rules already settled by the already existing treaties.

The history of European construction shows that the bold reforms are accepted much easier when their objectives are concrete enough to insure the support of the governments and of the public opinion. For the usual citizen (voter), the European Constitution project proved to be too abstract. In the same time, the Constitution project met will agreements in many aspects, thing which may inspire a new way. If the situation will constantly evolve, and the new projects will prove attractive, it will be proved that it is possible to fundament a new consensual evolution even without the formal guarantee of unanimity.¹

The movement of some activities of the European Union to the new structure would probably be imposed and even the reforming of the review procedure provided in article 48 of the European Union Treaty (the Maastricht Treaty) would be possible.

The same conclusion also applies to the reform process and other aspects of the European institutional frame, that is the European Union is in an unpredictable period of changes.

Although the diplomatic model used at the beginning, within which the states played a central role, is kept in the current Constitutional Treaty as well, it has certainly reaches its maximum limits.

Although the innovations brought in the last years, the intergovernmental nature of the reform process of the treaty did not modify.

This makes any substantial reform almost impossible. The many are those who can oppose veto, the greater is the risk of a deadlock. The paralyzing rule of unanimity must be reviewed, without bringing prejudices to the consensual nature of the process.²

¹ Renaud Dehousse – Op. cit, page 69.

² Renaud Dehousse – Op. cit, page 69.

II. THE VIABILITY OF A FEDERAL EUROPE

The American experience regarding the federalism may serve as a lesson for the Europeans, for the European Constitution project, as well as for the future of the European Union.¹

First of all, the ambiguity of the European Union regarding the existence of “an even more close (integrated) union” is not surprising. This takes it closer to the deep ambiguity existing in the American constitutional landscape between 1776 and the Civil War.²

In a certain way, the original Constitution of the United States of America, as well as the European Constitution project are alike through the fact that people see in them what they like to see. As Alexander Hamilton, James Madison and Thomas Jefferson approached the Constitution of 1787 in radically different ways, as well in the present moment the Euro-federalists and the Euro-skeptics find in the Constitution project reasons of content, respectively fear.³

The debates are also very alike. As Alexander Hamilton sustained the existence of a powerful American state-nation (European concept), with a high degree of economic and political integration, as well the former German Minister of Foreign Affairs Joschka Fischer expressed his hope that the European Union will transform into an integrated political federation. On the other side, Thomas Jefferson and James Madison, the opponents of Alexander Hamilton’s ideas are alike to the nowadays Euro-skeptics (especially the ones in Great Britain), who are afraid of the limitation by the bureaucrats from Brussels of their sovereignty and liberties (fear somewhat legitimate due to the fact that the community bureaucracy has been copied to great extend from the French one).

¹ Mark Christie – Political Integration in Europe and America. Towards a Madisonian Model for Europe, CEPS (Center for European Policy Studies) Policy Brief, no. 72/2005, page 8.

² Mark Christie – Op. cit, page 8.

³ Mark Christie – Op. cit, page 8.

Secondly, one cannot settled before if the European Union will become a federal union of American type. Although the European Union has some of the elements of a state-nation (flag, anthem, motto and national day) and it much more integrated than the American states of the years immediately after the conquest of independence by Great Britain, some obstacles may however be identified in the path of a more profound integration, differentiating the European Union from the United States of America from the period of its beginnings.¹

Although each of the 13 original American states (former colonies) had their own independency, own government and political culture, they concomitantly shared the same language, a religion and common culture (based on that religion, the Protestant Christianity), common legal principles (based on the British law) and a common history. Especially the common history and the fight against the British domination have been the arguments invoked by President Abraham Lincoln in his first inaugural speech, in 1861, in a final effort to convince the secessionist southern states not to rise in arms against the federal government. This common history could not prevent in 1861 the triggering of the Civil War, but it has been very important in the reconstruction of after 1865.

By contrast, while English rapidly becomes the dominant language on European plan in the commercial and superior learning fields, on national level persists the linguistic multitude. Under the current conditions, when there are 22 official languages inside the community space, besides the variety of written or spoken languages and dialects, this represents an obstacle for the transformation of the European Union in a federation like the one Joschka Fischer foresaw.²

Although the European Union disposes of a Christian past and legacy, it has on its territory an important Muslim minority and it also began the adhesion negotiations with Turkey, a Muslim state. It is not a coin-

¹ Mark Christie – Op. cit, page 8.

² Mark Christie – Op. cit, page 8.

vidence that many French and Germans, who for a long time have been the most vocal adepts of a more accentuated European federalism, are in the present moment much more moderated regarding the adhesion of Turkey as a member state. They are afraid that the adhesion of Turkey could represent a step back towards a more accentuated political union and a step forward towards the British vision of the European Union especially regarded as a free-trade area.¹

The Europeans, far from having a common history of fighting against the same enemies, had rather had wars between them. The French and Germans had seen the European Economic Community as a political mean of avoiding some destroying conflicts between their countries. Belgium, Luxembourg and Netherlands, who have seen their territories crossed by the French and German armies, followed the same purpose. The British always had a different vision. Great Britain, although it participated to the majority of the main European wars, has not suffered an invasion on its own territory since 1066 and regarded the political union on European level usually with skepticism, sometimes even with hostility. According to the former British Prime Minister Margaret Thatcher “In all my life, all the problems came from the European continent and all the solutions from the Anglophone countries in the world”.²

The European Union carried a great success through the fact that it brought in Europe the longest period of peace and prosperity in the modern history, thing which does not create however that type of European national conscience and patriotism that would lead to the creation of a new state-nation. The European citizens never fought as Europeans, under a common flag, against an enemy, as it happened to the American citizens. This historic factor, together with the lack of a common language, clearly represents major obstacles in the path of the creation of a European integrated political federation.

¹ Mark Christie – Op. cit, page 8.

² Mark Christie – Op. cit, page 8.

Thirdly, even though what is written on paper cannot guarantee the clear future evolution of the European Union, the importance of specific terms must not be minimized. The provisions in cause settle the legal frame and the future directions of development of the European construction. For these reasons, the analysis of the provisions of the European Constitution project is essential.¹

One must also consider the fact that all the precedent community agreements have been conceived as treaties. By the annexation of the two terms (the Treaty project instituting a Constitution for Europe), one may deduce that the authors of the project deliberately intended the creation of a confusion.²

Unlike the USA Constitution and the precedent community treaties, the European Constitution project directly refers to the question due to which the American territory faced a four years civil war and that is the secession of the member states. There is a specific provision according to which a member state is entitled to leave the Union, without the process or consequences of the secession being clarified.³

If a formal mechanism of the secession offers satisfaction to the Euro-skeptics, the supremacy clause has the contrary effect. According to the respective paragraph “The Constitution and the laws adopted by the Union’s institutions in exerting the competences that are conferred to them benefit from a primacy (supremacy) over the laws of the member states”.⁴

This language is very similar to the supremacy clause provided by the Constitution of the United States of America. According to this clause “the Constitution and all the laws of the United States voted according to it will be the supreme law of the land (territory). The judges in each

¹ Mark Christie – Op. cit, page 9.

² Mark Christie – Op. cit, page 9.

³ Mark Christie – Op. cit, page 9.

⁴ Mark Christie – Op. cit, page 9.

state will have to respect it, despite the contrary provisions of the Constitutions or laws of other states”.

The supremacy clause has been one of the main sources of the American federal government’s power towards the 50 component states of the federation. Even if some supporters of larger powers of the states disputed its application by the courts of law, nobody could contest its legitimacy. This was according to the conception of James Madison, who considered the United States of America as a composed republic, within which the federal Constitution, as well as the constitutions of the states arose from the people’s will.¹

Fourthly, the adoption method is essential, regardless if it is about a treaty between sovereign states or a classic constitution. According to the occidental democratic political tradition (with its origins in the period of Enlightenment), the governments are legitimate only if they are constituted according to the will of the governed ones. According to the former president of the USA, James Madison, “the last authority, wherever it is found, is the people itself...” This means that an European Constitution may be considered as being legitimate only if the European citizens of each member state explicitly express their agreement to be governed by it, either by referendum, or by a chosen assembly to ratify it.²

The European Union has had an oscillatory history regarding the use of referendum. Great Britain organized a referendum in 1975 having as theme the eventual abandonment of the European Economic Community (the predecessor of the European Union). Surprisingly, the British electorate chose not to leave the community structure. France put the Maastricht Treaty in front of the people’s vote, who approved the community document with a feeble small majority.³

¹ Mark Christie – Op. cit, page 9.

² Mark Christie – Op. cit, page 9.

³ Mark Christie – Op. cit, page 9.

Despite these examples and others, the history of community evolution has been directed by the European elite in the direction of economic and political integration, even in the absence of the people's support or against the public opinion, thing that made some annalists and commentators to talk about the European Union's deficit of democracy.

On one side, many Europeans, adepts of the objective of Rome Treaty of creating a new "union even more closer (integrated)" are skeptical regarding the submission of the European constitutional project to the people's referendum, to a vote of the people. While many Euro-federalists are afraid of the people's referendum (Germans, especially, are afraid of the referendum due to its use in the past by the Nazi regime), no Constitution can be legitimate as long as it does not have the approval of the European people.

The national parliaments, although elected, may exert only those powers which are delegated to them by the governed ones in the fundamental law, the Constitution. The parliamentary attributions (powers) cannot legitimately include the institution of a new form of government without the people's vote.¹

On the other side, it is ironic that many Euro-skeptics, especially the ones in Great Britain, are the adepts of the referendum for the purpose of adopting the European Constitution project. Evidently, they hope that the referendum will have a negative result. But if the result will be positive, as in 1975, the Euro-skeptics will no longer be able to say that the British government and the European Constitution act without the approval of the British people.

The request that all the 27 member states of the European Union approve the constitutional project is extremely difficult to fulfill. The accentuation of the anti-European feelings (or rather against the bureaucracy in Brussels) as well as the electoral scores obtained by the

¹ Mark Christie – Op. cit, page 9.

anti-European parties at the last elections for the European Parliament (2004) will make this project “a bridge too far away”.¹

The process of creating “an even closer (integrated) union” started 50 year ago will not stop under these conditions, but it will logically transform into “an Europe with two speeds” (problem approached in the last year, especially due to the context of the admission of new states). In reality, the Europe with two speeds already exists, being composed of the states in the Euro area and the ones outside it. Regardless if the European Constitution project will be ratified or blocked, it is probable that a group of member states, most of them inside the Euro zone, will try to elaborate a Constitution of a federal union more integrated than the existing one in the present.

Proceeding in this manner, the European integrationists will have to consider some aspects of the American constitutional history. Especially, it will be necessary to study more carefully the federalist principles of James Madison.

While the European Union is much more integrated in some aspects than the United States at the beginning of its history, the European integration is problematic given the possible obstacles. Even if USA did not face the same problems (the lack of a common language, religion, legal system, of a history and a national identity), the evolution of the United States into a federal union deeply integrated took place due to a civil war, fact possible on European plan.²

The literature regarding the federalism make the difference between the two ideal models (types), having as basis the different interpretations (ideas) of Montesquieu about the organization of political power. These are the separation of powers and the allocation (distribution) of powers.³

¹ Mark Christie – Op. cit, page 10.

² Mark Christie – Op. cit, page 10.

³ Tanja Borzel – What can Federalism teach us about the European Union? The German Experience, The Royal Institute of International Affairs, page 4.

The separation of powers, or “dual federalism”, corresponding to the model of the United States of America, emphasizes the institutional autonomy of different levels of government, following a clear separation of the powers on vertical plan. Each level of government has an autonomous sphere of responsibilities. The competences (attributions) are allocated more depending on the field of activity, than from the functional point of view. For each sector (field of activity), a certain level of government holds legislative powers, as well as executive powers. As a result, the entire governmental machinery is doubled, and each level conducts its activities autonomously. The dual or sector allocation of the competences is completed by a weak representation of the federal states on central level.¹

The second chamber of the federal legislative is organized according to “the principle of Senate”. According to this principle, the federal states are represented by an equal number of senators directly elected, regardless of the territory or population of the respective states. As a result (and in contrast with Bundesrat principle), the Senate does not reflect the territorial (local) interests, but the functional options of the electorate or of the political parties of those federal states.²

The federal states do not coordinate their interests through voluntary cooperation and coordination with the central (federal) government, usually by intergovernmental conferences. The institutional autonomy of each level of government also presumes a fiscal system which must guarantee the federal states enough resources to allow them to exert their attributions without financial (fiscal) interventions from the federal (central) government. The federal states usually enjoy an accentuated fiscal autonomy, which allows them to perceive their own taxes and to have independent sources of income.³

¹ Tanja Borzel – Op. cit, page 4.

² Tanja Borzel – Op. cit, page 4.

³ Tanja Borzel – Op. cit, page 5.

The distribution of powers or “cooperative federalism”, having Germany as prototype, is based on a functional division of the powers between the different levels of government. This means that the central level elaborates the laws, the federal lands being responsible for their application (implementation). In this system, most of the competences are “concurrent” or “shared”. This functional division of the power requires a strong representation of the lands’ interests on central level, not only to insure the efficient implementation of the federal policies, but also to prevent the transformation of the lands in simple “administrative agents” of the federal government. Their reduced capacity of self-determination (autonomy) is compensated by a high degree of participation to the legislative and federal decisional processes (mainly in the case of Bundesrat). The major political initiatives usually require the approval of will of the federation, as well as the majority of the federal lands. In this meaning, the chamber of territorial representation may be considered Bundesrat (Federal Council), within which the lands are represented by their governments, proportional to the size of the population.¹

The distribution of competences is completed by a common system of taxes. The federal government and the federal lands share the most important incomes from taxes, which allows the redistribution (reallocation) of financial resources from the lands with greater incomes to the ones with small incomes (fiscal equalization). The functional and fiscal interdependency of the two main levels of government does not give birth only to “the policies of coalescence” and “the mutual adoption of decisions”, but also determines the apparition of a system within which the policies are formulated and applied by the administrations from both levels of government (“executive federalism”). Unlike the dual federalism, the functional (non-territorial) interests are weakly represented in the federal decisional process and are based on

¹ Tanja Borzel – Op. cit, page 5.

alternative forms of interests' intermediation, such as the system of parties and the sector associations.¹

The European system of governance on multiple levels is apparently much closer to the cooperative federalism than the dual federalism. The European Union does not dispose of an autonomous sphere of competences in the meaning of concomitant holding of executive and legislative attributions in the case of certain sector policies. Even in the field of "exclusive competences" the European Union cannot legislate without the agreement of the member states (represented in the European Union's Council). With the exception of the monetary policy, there is no field in which the member states completely ceased the sovereignty to the European Union, thus excluding their direct participation to the decision making. This is true even in the fields of commercial policy, competition policy or agricultural policy.²

While the great majority of the legislative competences of the European Union are practically divided or concurrent, the responsibility of power in the application of the policies stays the task of the member states.³

The European Union disposes of a too reduced administrative device to be able to apply and implement the community policies. This functional division of the competences (attributions) or the division of the legislative powers confer to the national governments of the member states an important role within the European (community) institutions. Thus the Council of the European Union or the Council (former Council of Ministers) is alike to the second chamber of Bundesrat type of the European legislative. Within it, the member states are represented by their executives, the number of votes being directly proportional to the size of the population.⁴

¹ Tanja Borzel – Op. cit, page 6.

² Tanja Borzel – Op. cit, page 6.

³ Tanja Borzel – Op. cit, page 6.

⁴ Tanja Borzel – Op. cit, page 6.

As in the case of other federal cooperative systems, the coalescence of the competences, the functional division of labor and a second chamber of Bundesrat type act in the meaning of an asymmetry of the political representation, within which the territorial (local) interests are before the functional interests. The restrained financial autonomy of the European Union regarding the member states underlines the dominance of territorial interests within the community (European) political process.¹

The European Commission, the European Parliament or the Court of Justice of European Communities first of all represents the functional interests of the European Union. However, the members of these institutions are elected or assigned on functions based on the territorial representation. Even the president of the European Commission is named by the governments of the member states (even under the conditions of voting of commissaries by the Parliament), while the president of the Council is by definition nominated by the governments (based on the principle of rotation between the member states). Although all the three supranational community institutions are apt for extending their competences gradually, the Council is practically the community institution with the highest gravity in adopting the decisions. Its relationship with the European Parliament and the Commission (despite the Amsterdam and Nyssa Treaties) continue to be based on an asymmetrical balance of power.²

The European Commission, in its capacity of executive branch of the European Union, disposes of a limited authority in comparison to the Council, even if it has the power to settle its agenda, power based on the right of legislative initiative. Due to the fact that it is not the result of direct elections, the Commission disposes of a reduced political legitimacy. Moreover, the Commission depends on the member states regarding the financing and implementation of its own policies. For

¹ Tanja Borzel – Op. cit, page 8.

² Tanja Borzel – Op. cit, page 8.

these reasons, it enjoys a strategically reduced autonomy in the matter of negotiations against the Council. The European Parliament, as first chamber of the community legislative, succeeded in increasing the powers of co-decision in the community policy. However, the community policies cannot be adopted without the agreement of the Council. But even on the territory of the European Parliament, the local and territorial interests, due to the fact that an effective system of the alliances of European parties has not yet formed. Even the committee system related to the Council and partially to the European Commission reflects the amplitude of representation based on the local and territorial interests. The experts of these committees are usually selected from national governments and many times they have worked in the national administrative structures.¹

The predominance of local and territorial interests in the community institutional structures has a more pronounced character than in the case of federalist-cooperative systems (where some remedies of this situation exist).²

In Germany, the federal lands are strongly represented in decision making on central (federal) level through Bundesrat (the second chamber of federal legislative). On the other side, the federation, represented by the Bundestag (first chamber of the federal legislative and directly elected) and the federal government counterbalance the influence of local interests. The equilibrium is determined by the political identity and the federation's legitimacy, its domination within the legislative frame and budgetary competences. By comparison, neither the European Commission, nor the European Parliament can counterbalance the Council's domination.³

The representation of political interests in Germany is based on a well settled system of party vertical integration in both chambers of the

¹ Tanja Borzel – Op. cit, page 9.

² Tanja Borzel – Op. cit, page 9.

³ Tanja Borzel – Op. cit, page 9.

federal legislative. Even the neo-corporatist forms of intermediation (representation) of interests guarantee to the German economic interests a privileged access to the political process. By comparison, the European Union does not dispose of a well settled system of party vertical integration. There is no central arena (a central frame) of competition (concurrency) between the parties, neither within the executive, nor within the legislative. Not even the industrialists' associations or syndicates of the first rank can represent effectively the interests of European enterprisers or employees within the European (community) decisional process.¹

If they had wanted to save the European Constitution project, the European leaders should have faced two difficult problems.²

Firstly, they should have raised themselves over the narrow national or partisan (special) interests. Each member of the European Council will be individually responsible for the decisions collectively made. This liability (responsibility) is in the present moment important more than ever in the renegotiation of the European Constitution project which is in a dead end. The chiefs of governments should deal with the preparation of a common company, in order to insure the successful ratification of the new text.

Secondly, the European Council must insure a certain risk. The risk is that of bringing in front of the national parliaments and European people a new version of the project from 2004.

In order to make a decision of reviewing the document of 2004, the leaders of the European Union have two alternatives, on tactical as well as on strategic level.³

¹ Tanja Borzel – Op. cit, page 9.

² Andrew Duff – Operation Pandora, European Policy Center (EPC), Challenge Europe, Issue 16, February 2007, page 55.

³ Andrew Duff – Op. cit, page 55.

An alternative, expressed by the French president Nicolas Sarkozy, consists of the re-analysis of the original text, in order to draw up a “mini-treaty”, with or without promising ulterior radical reforms.

A second alternative is the one of a “new Constitution”, by modifying the initial text and bringing substantial improvements (which has been done).

III. THE UNITED STATES OF EUROPE

The fact that the founding (constitutive, institutive) treaties of the European Union may be characterized as being a “Constitutional Charter” may lead to their description as a “Constitution”. However, they are not identical or similar to a classic Constitution of a state. These treaties reflect the fact that the European Union, whose authority derives from the member states, does not dispose of some of the essential characteristics of a state.¹

In the present moment the European Union is far from having the necessary means and resources for a complete governing system:

- a) legal means: the implementation and control of respecting the provisions of the community right depends to the greatest extent on the national instances and administrations;
- b) human resources: the total number of community clerks is approximately half of the one of clerks of the Municipality of Paris;
- c) financial resources: the community budget represents a small part of the member states’ IGP (1.13% in 1999), and the large part of the expenses (85%) falls in the task of national administrations and are paid by them directly to the beneficiaries. Although the European Union has its own resources (its budget

¹ Jean-Claude Piris – Does the European Union have a Constitution? Does it need one?, Harvard Jean Monnet Working Paper, no. 5/2000, page 14.

does not depend on the contributions of the member states, as in the case of UNO or of other organizations), it does not have the power to settle taxes or to allocate resources, which can be made only through a decision, which then must be ratified by the member states;

- d) administrative and technical capacities: the Community has few operational means of control and action at its disposal, the administrative expenses representing only 4.6% of the total community budget;
- e) the constraint (coercion) means: the European Union does not dispose of means of constraint characteristic to a sovereign state, such as the army and police.

For these reasons, the European Union has been and probably will stay independent to a great extent from the member state and their legislative, executive, administrative and judicial structures.¹

The European Union is not a state. Its authority derives from the one of the member states.

An aspect which is probably clear for all the European (community) citizens is the fact that the European Union does not represent a state. For example, it does not have a chief of state. On the other side, the states forming the European Union have all the attributions of a state (chiefs of state and chiefs of Government, army forces, instances and courts of law, police, penitentiary system, etc.). The European Union is not a state-nation.²

An important criterion in defining a Constitution in the juridical dictionaries is the one of “nation” or “state”. From this point of view, the answer is clear. The European Union, although it has some of the attributes of a state, it is clearly not a state, and the citizens of the Union do not form one nation.

¹ Jean-Claude Piris – Op. cit, page 14.

² Jean-Claude Piris – Op. cit, page 16.

Black Juridical Dictionary defines the state as being “one people occupying permanently a fixed territory, governed by the same habits (traditions) and legal practices, forming one political body and exerting through an organized governing, independent sovereignty and control over all persons and goods in the territory of its borders, capable of making war and peace and of settling international relations with other communities in the world”.

However, it would be useful to analyze this definition.¹

1) One people or several peoples?²

The first element in defining a state refers to the people, as it happens for example, in the preamble of the Constitution of the USA, which begins with the words: “We, the people of the United State”.

Concerning the European Union, indubitably it is formed of several peoples, and the Treaty of the European Union refers in its preamble to “an even closer union between the peoples of Europe”.

The notion of the existence of one people must not be exaggerated. There are several states whose citizens have different ethnic origins and speak different languages. We cannot report to one person only in the terms of citizenship or the affiliation to a common language, but also in terms of affiliation to a certain town or region, these affinities presuming factors beyond the national borders.

It is obvious that Europeans share common and distinctive aspects, though being different from other peoples and societies, from geographical, historical and cultural points of view.

From the historical point of view, the Europeans have the roots of their civilization in Judeo-Christianity, antic Greece and antic Rome. As soon as the Enlightenment, the term “Europe” started to be used and adopted step by step.

¹ Jean-Claude Pirus – Op. cit, page 16.

² Jean-Claude Pirus – Op. cit, page 17.

From the cultural point of view, despite its richness and diversity, Europe is clearly different from other continents, although the differences regarding North America are less pronounced. In the same time, “the European social model” is different from the American one.

- 2) The sovereignty and attribution (distribution) of powers (competences)¹

Referring to the second element of the definition of a state, the state must have “independent sovereignty”. Black Juridical Dictionary defines sovereignty as being “the self-sufficient source of the political power, from which all the specific political powers derive”. On other words, a state enjoys sovereignty and power from the legal point of view over all the fields of governance, with the exception of the ones it specifically waived through the Constitution.

It is very clear that the European Union and the European Community (the European Economic Community) do not dispose of “independent sovereignty”. Moreover, the European Community is governed by the principle of attributing (sharing) powers (competences), as it is specified in the CE Treaty, according to which “the Community will act in the limits of the powers that are conferred to it by the Treaty and of the objectives that are attributed to it”. This means that, unlike state-nations, which are sovereign by definition, CE (CEE) disposes only of those powers that are attributed to it by the treaties. Each action of CE must be based on a specific disposition of the CE Treaty, which confers it the respective attribution (power), request which is strictly controlled by the Court of Justice.

Contrary to what some people think, article 308 (former 235) of the CE Treaty does not allow the exertion of any competence which is outside the purpose of the Treaty. Although it is true that the formulation of this article is not very precise, an extensive approach is not possible, neither from the ethic point of view, nor from the legal point

¹ Jean-Claude Piris – Op. cit, page 18.

of view. The Council has a more restrictive approach in using this provision than in the past, especially after two opinions of the Court of Justice, no. 1/94 and no. 2/94. In this context one can mention “the Maastricht decisions” of the German and Danish Supreme Courts.¹

3) Control over all persons and goods²

The third element of state’s definition in Black Juridical Dictionary is the exertion of “control over all persons and goods within its borders”. Although the Community has the power to regulate many economic sectors, it does not dispose of control over persons and goods. Regarding this aspect, it must base on the administrative and coercive devices of the member states in order to insure the correct application of the provisions of community law.

4) War and peace (to start and wage the war and to make peace)³

A state, according to the fourth element in Black Juridical Dictionary “is capable of making war and peace”. The European Union does not dispose of such powers (is does not have an army, common defense, it does not participate to military alliances). Altogether, the Community and the Union may adopt certain measures considered hostile (unfriendly) in international law, such as trading embargo or other sanctions imposed to a third party. Besides this, the progressive delineation of a politics of common defense is explicitly studied and actively discussed.

5) International relations⁴

One of the last elements of the state’s definition in Black Juridical Dictionary is “the settlement of international relations with other communities in the world”. The European Community has legal personal-

¹ Jean-Claude Piris – Op. cit, page 19.

² Jean-Claude Piris – Op. cit, page 19.

³ Jean-Claude Piris – Op. cit, page 19.

⁴ Jean-Claude Piris – Op. cit, page 20.

ity and the competence to sign treaties, but it may sign international agreements only in those fields that are in its attributions (powers). To the extent in which an international agreement covers fields in which the competences are shared (distributed) between the Community and the member states, the member states are free to exert these competences on their own, by signing agreements on their own behalf. To the extent in which the European Union is also affected, it has the power to sign treaties, in the fields provided by Title V and Title VI of the European Union Treaty. This strengthens the argument according to which the European Union is implicitly a legal personality, even in the lack of express provisions in this meaning.

After mentioning all these different elements of a state's definition, two conclusions may be drawn. On one side, the European Union is not a state, and on the other side, the member states did not keep their entire sovereignty and full liberty of action, but they transferred some powers to the European Union or are sharing them inside the Union.

- 6) The European Union does not obtain (extract) the authority directly from the citizens, but from the member states¹

An important element of defining a Constitution in Black Juridical Dictionary is that "it extracts its entire authority from the ones it governs". This is the case of the Constitution of the United States of America, which, in its preamble, shows that "We, the people of the United States... have decided and laid down this Constitution".

By contrast, the community treaties are signed under the form of international agreements between the chiefs of states. Moreover, the Court of Justice, in the opinion no. 1/91, shows that the Rome Treaty is "a constitutional charter ... its subjects not being only the member states, but also their citizens". On other words, the Community brings together not only the member states, but also their peoples, "citizens of the Union".

¹ Jean-Claude Piris – Op. cit, page 21.

One cannot deny the fact that the constitutive (original) authority for the negotiation and adoption of any amendments to the treaties remains in the competence of the member states.

The Constitutional Charter of the European Union cannot be compared to a national constitution of a classic state, as in the community treaties is affirmed that “the Union will respect the national identities of the member states” and that “the citizenship of the Union will complete and not replace the national citizenship”.

The doubt (mistrust) can be diminished if the following problems are clarified.

Firstly, the international legal personality is not the first step to the apparition of a super-state (supra-state). For example, the Organization of the United Nations has a history of more than 50 years and nobody thought of transforming it into a super-state.¹

Secondly, the international legal personality does not have an influence over the competences (attributions) of the organization that achieved it. These organizational competences result from its constitutive papers (documents), without having any connections to the legal personality.²

Thirdly and lastly, the international legal personality has nothing to do with the intergovernmental or supranational character of the organization that achieves it. Some intergovernmental organizations have it, others do not.³

One may argue that a treaty recognizing the legal personality and reaffirming that some of the problems presented above, it may confer some guarantees.

¹ Philippe de Schoutete, Sami Andoura – The Legal Personality of the European Union, In *Studia Diplomatica*, Vol. LX, no. 1/2007, page 8.

² Philippe de Schoutete, Sami Andoura – Op. cit, page 8.

³ Philippe de Schoutete, Sami Andoura – Op. cit, page 8.

The absence of an explicit clause of the treaty in this meaning will not implicitly diminish the Union's legal personality, recognized on international level and denied (disputed) only by a small number of member states. The situation may evolve so that it has done in the last years, under the form of new treaties signed with several partners. Some ambiguities still remain, and the coexistence of two legal entities, the European Union and the European Community will be embarrassing, being in contradiction to the fundamental unity of purposes.¹

IV. THE LAST EVOLUTIONS OF THE EUROPEAN CONSTITUTIONAL PROCESS

In 2005 six alternative scenarios (variants) were taken into consideration in the situation of non-ratification:²

- 1) The treaty is submitted to a second vote by the states that did not ratify (voted) it.
- 2) The states that did not ratify (voted) it leave the European Union and start a new Constitutional Treaty.
- 3) The states that did not ratify (voted) it leave the European Union and start together a new political union, which will apply the Constitutional Treaty.
- 4) A new Inter-Governmental Conference is settled, in order to re-negotiate either some aspects of the Treaty, or the entire Treaty.
- 5) The Treaty is considered "dead" and the European Union continues to function based on the Nyssa Treaty.

¹ Philippe de Schoutheete, Sami Andoura – Op. cit, page 8.

² Julia De Clerck-Sachsse – What if they say "non"? Alternative scenarios if the European Constitution is rejected, The Oxford Council on Good Governance Briefing, no. 4/2005, page 2.

- 6) Some aspects of the Constitutional Treaty are applied through methods that do not require the amendment of the Treaty.

The Intergovernmental Conference will draw up a “Reform Treaty”, and the amendments to the Treaty will not have “a constitutional character”. The two main clauses of the Reform Treaty will amend the Treaty of the European Union (TUE – Maastricht Treaty) and the Treaty instituting the European Community (TCE – Rome Treaty), but changing the name of the last into the Treaty for the European Union’s functioning.¹

The European Union will have only one legal responsibility, which will not replace the national representation within the international organizations, such as the Organization of the United Nations. All references to “the European Community” will be removed and replaced with “European Union”. There will be no elements of statehood, such as flag (banner), anthem or motto.

It is shown that the ones with primacy in front of the legislation of the member states will be the treaties, community legislation and the jurisprudence of the Court of Justice of the European Union.²

In order to strengthen this principle, the opinion of the Legal Service of the Council regarding “The Primacy of the Community Law” will be annexed to the Final Document of the Conference.

The main (key) amendments to the Treaty of the European Union are grouped in many categories.

Regarding the values and objectives of the European Union, the reference to “the free and undistorted competition” has been eliminated from the objectives of the European Union (on France’s request), but

¹ Vaughne Miller – EU Reform: a new treaty or an old constitution? House of Commons Library Research Paper, no. 07/64/2007, page 34.

² Vaughne Miller – Op. cit, page 34.

the importance of competition (concurrency) is highlighted within a Protocol project in the field of internal market and competition.¹

The Charter of Fundamental Rights will have “a compulsory legal value”, although it will not be incorporated (reproduced) in the Treaties. The text, initially provided in the Nysa Treaty has been integrated into the European Constitution project. It cannot be applied by the Court of Justice of the European Communities – CJCE, although it has been taken into consideration in the formulation of some decisions of the Court. The European Union has already incorporated an Agency for Fundamental Rights, with the seat in Vienna, which monitors the community institutions and the governments of the member states regarding the observance of community legislation and the obligations of observance of human rights and which formulates opinions for the interested governments and institutions.²

The Charter will be renewed by the three main community institutions. A statement will mention the field of application of the Charter and its relation to the European Convention of Human Rights. A protocol will state the British instances (courts) or the Court of Justice of the European Communities cannot state the British laws as being incompatible to the Charter. The effect of this exception is disputable, as it undermines the fundamental principle of the states’ obligation to adhere and to apply the community *acquis* (community legislation, the treaties and the jurisprudence of the Court of Justice of the European Communities). It has been suggested that the indirect impact the Charter will have on the British legislation, especially when CJEC will pronounce in other cases.

Regarding the competences, the provisions of the Constitution regarding the relations between the Union and the member states will be maintained, a specific provision according to which the European Union “will act only in the limits of the competences conferred by the

¹ Vaughne Miller – Op. cit, page 34.

² Vaughne Miller – Op. cit, page 35.

member states in the Treaties” being added. The national security (safety) is explicitly defined as of the competence of the member states.

The role of the national parliaments in the European Union will be settled through a new article, which will also show “how they will actively contribute to the good functioning of the Union”. It is for the first time when the community treaties mandate the action of national parliaments.

Their contribution (activity) will consist of the following:¹

- obtaining information and legislative projects from the community administrations;
- insuring the observance of the subsidiary principle;
- participating to evaluation mechanisms for policies in the field of Justice and Internal Affairs – JIA, especially in Europol and Eurojust monitoring and evaluating;
- participating to the procedures of reviewing the Treaties;
- receiving notifications and adhesion requests from the European Union;
- participating to inter-parliamentary cooperation activities between the national parliaments and the European Parliament.

The European Constitution conferred to the national parliaments the possibility of expressing objections to the provisions of the community legislation because of the non-observance of the subsidiary principle. The objections must have been formulated within six weeks by the parliaments of at least one third of the member states. In this situation, the Commission must review the proposal.

The subsidiary guarantee for the national parliaments will function as follows:¹

¹ Vaughne Miller – Op. cit, page 36.

– The national parliaments will have eight weeks to examine the legislative proposal and to formulate a motivated opinion over tributariness. Each national parliament will have two votes (one vote for each chamber in the bicameral parliaments). On the occasion of the re-examination, the Commission will analyze if the proposal is maintained, will modify it or will withdraw it.

– Within the ordinary legislative procedure, if the motivated approvals regarding the nonobservance of the subsidiary principle by a legislative proposal represents the simple majority of the votes attributed to the parliaments of the member states (28 of 54), the Commission will decide if it maintains the proposal, modifies it or withdraws it.

– In case the Commission decides to maintain the project (proposal), it must formulate a motivated opinion, submitted then to the European Parliament and the European Council together with the motivated opinions of the national parliaments.

– The European Parliament and the European Council must then analyze the compatibility of the legislative proposal with the tributariness principle, taking into consideration the opinions of the Commission and of the national parliaments.

– The proposal may be eliminated if the majority of the European parliamentarians, or 55% of the Council's members consider that the proposal is incompatible with the tributariness principle.

In the present moment, the parliaments approach the tributariness problems in the relation with their governments in order to present them within the Council of Ministers. But nothing prevents them from writing directly to the Commission about the tributariness problems (aspects).

Regarding the institutions, the modifications of 2004 are maintained.²

¹ Vaughne Miller – Op. cit, page 37.

² Vaughne Miller – Op. cit, page 37.

– Beginning with 2014, there will no longer be one commissary for each state, the number of commissaries representing 2/3 of the number of the states. The Commission must reflect correspondingly the demographical and geographical proportions (dimensions) of the Union. The Commissaries will be selected based on an equal rotation system between the member states and will have a mandate of five years.

– The European Council will be considered as an institution of the European Union, with a permanent presidency, which will not be depending on the rotation of the presidents of the member states at the management of the Council (the Council of Ministers).

– The European Council will have management teams (groups) with a mandate of 18 months. Each management team will be composed of three member states, each holding the presidency for six months.

– The voting system provided by the Nyssa Treaty will function until November 1st 2014. After this date a voting system of double majority (a qualified majority will need 55% of the votes in the Council, representing at least 65% of the community population) will be applied. Between November 1st 2014 and March 31st 2017, any member state may request the return to the Nyssa system. In the same period, if the member state representing 75% of the Council's votes or 75% of the population necessary for the incorporation of a minority blocked in the Council, express the opposition to a certain proposal, a final vote over the proposal may be postponed in the try to reach an agreement. Since April 1st 2017 this final vote may be postponed if 55% of a blocking minority (in votes or in population) manifests its opposition.

In the field of the European Union's external politics, the controversial title regarding the Minister of the Union for Foreign Affairs has also been modified (combining the functions of Commissary for Foreign Relations and the High Representative for PESC). The denomi-

nation of the function will be modified in “The High Representative of the Union for Foreign Affairs and Security Policy”. The external action of the Union is in the present moment in the attribution of the Council through PESC and the Commission in the field of the international organizations, trade and negotiation of the treaties. The Constitution Project considered the function of Minister of Foreign Affairs necessary for the increase of coherence, consistency, efficiency and visibility of external actions of the European Union. The Commission analyzes the means of improvement of the cooperation between the Commission, Council, community institutions and member states.¹

Regarding the external actions and the External and Community Security Policy (PESC), the provisions of the Constitutional Treaty for the Service of European External Action and structured cooperation in the defending policy will be mentioned, but a Declaration will underline the existing responsibilities of the member state for the formulation and management of the external politics and representation in the international relations. The chapter regarding the external actions and the External and Community Security Policy will detail the procedures and rules applicable in the PESC sector. PESC will keep its intergovernmental character in its nature, and the decisions will be taken in unanimity. PESC provisions will be maintained in the European Union Treaty, and a declaration of the Intergovernmental Conference show that the PESC provisions will not affect the responsibility of the member states (as it is in the present) regarding the fundament and management of their external policy, or their international representation regarding third countries or international organization.²

Regarding the strengthened cooperation, the strengthened cooperation actions will be triggered with the participation of at least nine of the member states.

¹ Vaughne Miller – Op. cit, page 38.

² Vaughne Miller – Op. cit, page 39.

Other final provisions consist of the following:¹

- The European Union will have legal personality, although a Declaration will confirm that the European Union is not authorized to act outside the competences conferred by the member states in the Treaties.

- The article regarding the voluntary withdraw form the Union is also kept.

- The provisions of the Constitution regarding the review of the Treaties without appealing to an intergovernmental conference will be reunited in one article, which will clarify if the review of the treaties will reduce or increase the European Union's competences.

- The conditions of adhering to the European Union will be amended.

The key (main) amendments to the CE Treaty cover several aspects.²

In the renamed Treaty over the functioning of the European Union, all referrals to the European Community will be removed, reflecting the collapse of the structure of the 3 pillars and the incorporation of an omnipotent European Union.

Regarding the functions of the European Union, the Treaty will be amended in order to include the amendments of 2004 of the Constitution project:³

- competence fields;
- the domains of the qualified majority vote (the Constitution project had modified the way of voting from unanimity to qualified majority in 15 articles and had introduced 24 new articles presuming the vote with qualified majority);
- the fields of co-decision with the European Parliament;

¹ Vaughne Miller – Op. cit, page 39.

² Vaughne Miller – Op. cit, page 39.

³ Vaughne Miller – Op. cit, page 40.

- the distinction between the legislative documents and the non-legislative ones;
- a “solidarity clause”;
- perfecting the Euro system;
- provisions over the own resources, multi-annual financial frame and the budgetary procedure of the European Union;
- provisions in the field JIA (Justice and Internal Affairs), such as the modification of the voting system and the veto right.

A number of modifications of the text of the Constitutional Treaty will be performed through additions:¹

- a specific language regarding the definition of a member state and of the European Union’s competences;
- the amendment of the coordination and cooperation measures in the field of diplomatic protection and consultancy;
- a protocol containing interpretative provisions regarding the services of general economic interest;
- a specific language in order to allow some member states to implement certain measures in the field of judiciary and police cooperation, while other states do not participate to these actions;
- an extension of the option of Great Britain in 1997 of not participating to certain actions in the field of judiciary cooperation in criminal matter and police cooperation;
- the role of the national parliaments in applying the bridge clause (procedure of simplified review) in the field of judiciary cooperation in civil matter regarding the family right problems;
- a reference specific to the solidarity between the member state in the field of energy supply;

¹ Vaughne Miller – Op. cit, page 40.

- restrictions in the field of European space policy;
- the specific reauthorization given to the European Union to act for the prevention of climate changes on international level;
- keeping article 308 of the CE Treaty (flexibility clause), but specifying that it is not applicable in the case of External and Community Security Policy – PESC.

V. CONCLUSIONS

At a first superficial sight (analysis), the history of the evolution of the European construction is to great extend the one of European elite that accelerated the process of economic and politic integration without the support of the people and sometimes even against the sentiments of the public opinion, which made many commentators refer to the “democratic deficit” of the European Union.

If we deepen the analysis, the situation is completely different.

As a result of the Inter-governmental Conference, we can extract the following main conclusions.

The most important conclusion is that the concept of European Constitution has been completely eliminated, reaching the solution of modifying the Treaty instituting the European Community (Rome Treaty) and the Treaty for the European Union (Maastricht Treaty). This will also have an indirect negative effect on the idea of a European federal supra-state.

The second conclusion in the order of importance is the inclusion of the jurisprudence of the Court of Justice of the European Union (which will include the Court of Justice of the European Union, the Tribunal of First Instance and the specialized tribunals, in the present only one existing, the Tribunal of Public Function), as the third main spring of the community law (the other two already being mentioned in the European Constitution project). The jurisprudence as spring of

law is characteristic firstly to the Anglo-Saxon law system. However, maintaining the jurisprudence as spring of law it had already been present more in the theoretical works of community (European) law, now being dedicated for the first time from the theoretical point of view to the provisions in the treaties.

The role of the national parliaments will be bigger than in the present, which will lead directly to the diminution of the role of the European Parliament. Thus, all consultative documents of the Commission (communications, White Books, Green Books), will be transmitted to the national parliaments before publishing them. The Commission will transmit to the national parliaments the legislative program as well, annually, the legislative programming or political strategy instruments, as well as the proposals of legislative documents concomitantly to the their transmission to the European Parliament and the European Council. The European Parliament also sends automatically all its legislative proposals to the national parliaments. Finally, the legislative documents projects coming from a group of member states, from the Court of Justice of the European Union, from the European Central Bank or from the European Investment Bank are transmitted to the national parliaments by the Council.

Regarding the functioning of the tributariness guarantees, each state will dispose of two votes, regardless of the parliamentary (unicameral or bicameral) structure. This will oblige the member states to accelerate and to simplify the internal parliamentary procedure, either to transform into a unicameral parliament. Anyway, some states which in theory are bicameral, in practice are unicameral (Germany and Great Britain).

A new aspect that might create difficulties are the different law systems of the formed communist states that adhered in 2004 and 2007. Even if in general lines they may be situated in the Romano-Germanic law system, they keep elements of the socialist law systems, especially in the sphere of public law.

A new element is added to the structure of the Commission. Thus, beginning with 2014, there will no longer be one commissary for each member state, but the number of commissaries will be equal to $2/3$ of the number of the member states. This will be performed based on a rotation system. It is not clear how this system will function, which may generate anomalies and tensions.

Another great step back towards the former European Constitution project is the dissolution of the function of Minister of Foreign Affairs of the Union. In its place will be the High Representative of the Union for Foreign Affairs and Security Policy, which will preside concomitantly the Council for Foreign Affairs within the European Council. The European Council and Commission will be the most powerful community institutions (which will make the functioning of the European Union more dependent on the national governs and parliaments). The attributions of the minister designer would have superseded especially with the ones of the president of the Commission.

Neither in the new European constitutional – institutional configuration there is no mentions about Christianity. There can be two motivations of this omission, one from the field of internal policy, and the other from the field of external policy. The internal political motivation refers to the increasing number of Muslims from the community space (and the fear of recrudescence of extremism and Islamic terrorism). From the external policy's point of view, Turkey is seen as a future member state, to whose predispositions must be spared, especially due to the electoral increase of Islamists at the last parliamentary elections.

The qualified majority replaced the unanimity in many situations, but anyway, the voting way does not encourage reaching fast and concrete results.

The European Union will have legal personality, important aspect firstly in the field of external relations.

Related to the legal personality, there will be no elements of statehood (anthem, motto, flag).

As can be seen, the European Union is in the present moment in a crucial period for its future evolution and, at least for now, it looks like it will not dispose of ideas about how this evolution will go.

This dilemma is not exactly surprising if we think about the beginnings of the community construction.

Everything started a few years after the end of the Second World War, when most of the European continent was in ruins, this besides the division due to the beginning of the Cold War.

Since the beginning it was intended to take over more or less faithfully, the model of the United States of America, especially due to the fact that nothing could have been developed without the support offered by the Marshall Plan (1947) and the creation of NATO in 1949, both of them started under the aegis of the USA. USSR riposted by creating ACER in 1949 and the Warsaw Treaty in 1955. The European moved more hardly by signing the CECO Treaty in 1951 and the 2 Rome Treaties (CEE and Euratom) in 1957. We must take into consideration the moment of the apparition of the concept of “The United States of Europe”, during the revolutions of 1848, when the preferred book of many European revolutionaries was “Democracy in America” written by Alexis de Tocqueville. As we can see, there are many common points between the USA and EU, which unfortunately are forgotten in the present moment in the favor of dissension.

From the practical point of view, the more or less identical taking over of the American model would have been impossible, due to several differences (aspects).

First of all, on the territory of the American federation “melting pot” principle applies, according to which all the citizens are uniformed by adopting the same languages and set of values. In practice, the Americans are reticent in recognizing the minorities, emphasizing the conferring of individual rights, not collective rights, as the Europeans do. Due to this reason, the racial incidents have usually a smaller amplitude.

Secondly, the minorities in USA have an important role in defining the external policy (Jews, Irish, Poland, Italian, Armenian, Greek, etc.).

Thirdly, the interest groups (PAC – Political Action Committees), the civil society, the NGO's, the universities, are much more powerful and have a more powerful word to say in front of the political factors. To these also contributes a much more clear legislative frame of lobby activities.

Fourthly and lastly, there is a much more simpler system of parties (only 2, presenting ideological qualification differences).

After the end of the Cold War, the collapse of USSR and the communist block, the European Union partially lost its objectives and reasons of its existence.

From the political-diplomatic-military point of view, on the first plan is USA and NATO. The role of UNO reduced a lot, being still in crisis. Even regarding the situation in Bosnia and Kosovo, their solving from the political-military point of view has been imposed by the United States, the Europeans subsequently involving in keeping the peace and reconstructing. The only place in which the USA, NATO and EU cooperate is Afghanistan (where a NATO mandate exists).

It is obvious that the three main powers on European level are France, Germany and Great Britain.

Of these three, the most European country is France. Great Britain has common interests with the United States and the Anglophone world, and Germany is tightly connected to Russia and former communist countries of center and south-east of Europe. As a proof in this meaning, one can mention the Ostpolitik started in Germany in the 70's, for the closeness of these states. Germany had a special reason for this. The German political class saw the German reunification performed through European reunification. In this meaning, a national strategy has been elaborated followed consequently until 1990 (an example that should be taken by Romania as well).

If these three states would cooperate more closely, the future of the European construction as well as the transatlantic relations would be more clearly contoured. There are encouraging signs in this meaning, such as the recent constitutional compromise within the Intergovernmental Conference. In other fields there are profound divergences, such as the Iraq problem.

As a result of the analysis of the last evolutions, one can say that Great Britain strengthened its position on European plan. The proof in this meaning are the express mentioning of the jurisprudence as spring of the community law and the exclusion from the text of the Treaties of the provisions of the Fundamental Charter of Human Rights. Besides these, it can take over the best from America, as well as Europe.¹

The new British prime-minister, Gordon Brown, affirmed in this meaning that “the United States have initiative, but they do not have correctness, Europe has correctness, but it lacks the initiative”.

The Europeans may take over from the Americans the innovations (research – development), the tax system and the conditioning of social aids for performing a labor, and the Americans can take over from the Europeans the public health system or the transports system in common.²

Regarding the European social politic, the European states are too assisting in comparison to the United States. If the pensions system is not reformed and the birth rate is not stimulated, it is possible that in 2025, the European state can no longer pay pensions.

France and Germany insured the management of the European construction process for 40 years.

¹ Timothy Garton Ash – *Lumea libera. America, Europa si viitorul surprinzator al Occidentului*, Ed. Incitatus, Bucharest, 2006, page 203.

² Timothy Garton Ash – *Op. cit.*, page 203.

The events of the last years proved that this system can no longer continue. If Great Britain does not join this group, it can form alliances with states such as Italy, Poland or Spain.

It is not compulsory to happen like this. In the last months it is observed a discrete alliance France – Great Britain departing from Germany. The main reason of this state of facts are the relations with Russia. Germany depends a lot from the energetic point of view by Russia, while the French and the British base on nuclear energy and petroleum from Persian Gulf. It is possible that a more substantial European participation for the solving of the situation in Iraq would contribute to the closeness of the American-European relations and to the reduction of the energetic dependency by Russia. The unilateralism of the current American administration harden the solving of this problem.

It is likely that a democratic administration in the White House or a more moderate republican administration would ease the situation. We must mention that the period of the mandate of George Bush senior enjoys a great consideration on the European continent due to the help offered on the period following the end of the Cold War.

However, the French and German governments are more pro-American than their predecessors.

Due to the European multi-polarity in a unipolar world it is possible that the European states adopt different positions, due to their national interests.¹

It is possible that some European states consider that good relations with Russia and supporting it would contribute to the elimination of unipolarity. It is a false reasoning, taking into consideration the authoritarian tendencies of the Russian political class and its last statements and actions, that converge to a new Cold War.

¹ Timothy Garton Ash – Op. cit, page 211.

We must mention (as an example for Romania) the position of Poland within the European constitutional compromise.

Ever since the reunion in Nyssa in 2000, Poland insisted on the number of the population to be taken into consideration, as well as on the system of double majority. The Spanish parliamentary elections of 2004 left Poland without allies in this problem.

However, the failure of the European Constitution project determined the come-back of Poland in first-plan and due to its non-ratification on internal plan through the postponement of the people's referendum.

According to the system proposed by the Polish, small states that contributed net to the community budget would enjoy a smaller influence in the disadvantage of state with a smaller population, but having a more reduced contribution (the situation of Poland and Romania).

Romania supported the position of most of the great states, not Poland's (as it would have been normal).

This emphasizes the fact that regarding the formulation of a position of Romania at the European Council the consultation of the public opinion does not exist, the consultancy with the political parties happening one day before the start of the Council's works. The example of Poland must be followed by founding the position in the European matters through an ample consultation of all directly interested internal factors, such as the consequent pursuit of some principles and defending our interests even with the price of a conflict with the community partners.

A factor that contributes to the smaller influence on the international arena of the European Union is the lack of a fast reaction force (whose incorporation is foreseen for about 8 years and which could easily reach 60,000 – 100,000 militaries). For this, the European states should increase the military expenses.

In the present moment, the European Union is in a critic moment of its evolution, which will have effects on Romania as well.

First of all, the European Union will have to decide if it will take only the way of a closer union (integration) only on economic and social plan, or an institutional, military and political plan as well (thing which until the present moment proved much more difficult to perform).

Secondly, it will have to be more transparent and much closer to the needs and aspirations of the common citizen. Here is where we have to find the explanation of the failure of the former European Constitution project, not in the opposition to a more integrated Union, as it was wrongly interpreted by the European leaders and political parties. In this context, we must mention that the last Euro-barometers show an increasing mistrust in the European Union project, but a decreasing trust in the political parties and community institutions.

Thirdly, the activity of the community institutions must be controlled effectively. This will be probably performed mainly by the national parliaments (which will have a greater role than in the present in the community concert) and by the civil society (which according to the same Euro-barometers, together with the NGO enjoy an increasing trust). The foreseen European patriotism (a sort of abstract formulation) cannot exist and it would be absurd without having as basis the national, regional and local patriotisms).

Fourthly, the European Union should define more clearly the role in the international arena, through an own conception on long term and not by exacerbating the transatlantic differences and automatic and puerile adoption of attitudes contrary to the ones of the United States of America. The starting point in this meaning is the Interdependency Statement foreseen more than 40 years ago by the American president John Kennedy.

Fifthly, the European Union needs to clarify the limits of its extension.

Lastly, Romania must find the right place in this context. It is necessary to adapt to a new set of values and to pursue with consistency the national interests, through an opened dialog with the European partners, not through a subordinated attitude. We must know very well what we can offer to the European Union and what we can ask from the European Union.

In the conclusion, it is very eloquent to mention the words of the count Coudenhove-Kalergi, one of the coryphaeus of the European unification, words said in Hague in 1948, "Let's never forget, my friends, that the European Union is a mean, not a purpose".

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The Way to Victory-Using Military Strategies in Business Situations

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As military strategy preceded firm strategy, it is natural to state that firm strategy took the majority of its main concepts from the military. Nowadays, the business environment plays an important role in adopting strategic decisions. This implies that in the center of a company's view, competition stands for one of the important factors. The interactions between economic agents become more and more intense, leading to firm cooperation, strategic partnerships, firm cluster and firm networks. However, there are also many ways for companies to engage in conflict. For some companies the most suitable approach to conflict is the attack. I considered a company from the mobile telecommunication sector in Romania and showed how applied military techniques can improve the company's performance.

Key words: *company warfare, firm strategy, military strategy, aggressive behaviour*

JEL classification: *D74, L21, L22, L25, M21, M31*

1. Rationale

The roots of the word “strategy” can be found in antiquity when the title of “strategos” was given to ancient Greek City-States’ army generals. The term strategy quickly entered mundane vocabulary and after a period of refinement, military strategy became an army leader’s art through which he could control the total amount of armed forces and technical resources needed to obtain victory. Even in those days a series of concepts and military ideas emerged and formed a coherent

core of strategic principles and even though at the time, the elaboration of a universal codex was out of the question, because the high degree of army heterogeneity. The modern signification of the concept derives from a Chinese thesis dated 500 BC “Sun Tzu - The Art of War”, considered to be the first treaty on strategy.

Today a vast number of approaches exist on firm and corporate strategy, famous economist like George Steiner, Henry Mintzberg, Kenneth Andrews, Michael Porter, Michel Robert and B.H Liddell Hart, each capture various core elements of a coherent business strategy. So basically, one has to wonder what a strategy is really. Is it a plan? Does it refer to the ways one can achieve its goals? Does it represent a solid attitude that a company adopts? Or does strategy refer to the perspective, on the approach of a company regarding its objectives, general decisions and actions? Does a strategy represent a pattern of a company's actions, by example mimicking the behavior of another company in a series of “I can do that too” actions?

Some might argue that to some degree all the before mentioned are true, that strategy represents a perspective, a position, a plan and a pattern. Others might say that the strategy represents the connecting bridge between a company's policies, tactical objectives and concrete actions to be followed. In a simple manner the strategy is the link between an objective's end and the exact means to achieve that goal. So simplifying things, one can say that a series of ideas and experiences that ensure the achievement of a unique single goal, given unique set of restrictions (reality), can be called a strategy. So strategy represents both “the planning” of a route and “walking” the path.

Properly defining the concept of strategy will further aid us in the adoption of the correct set of decisions. One must note that the structure and sequence of decisions will differ in various strategic approaches on the same matter. Also taking a correct decision at any given time isn't nearly as important as making a correct series of decisions that have logical continuity.

In essence every manager prior to elaborating a strategy must ask himself some questions whose answers will guide him towards answers to the problems at hand:

- What is the current strategy?
- Which are the hypotheses on which the current strategy is based upon?
- What is happening with the economic sector in which the company activates?
- What is happening with the competitors?
- What kind of technology does the company possess?
- What products and services will the company offer?

2. A brief example

In order to better understand how military strategies can be used in business situations, one can study the innovations of Napoleon Bonaparte and how these can be implemented in real situations. Napoleon developed four key techniques: he increased the speed of movement of his army, he organized his army into self sufficient platoons, he used supplies only from conquered territories and he attacked enemy supply lines. All these innovations can be found incorporated in real business cases.

1. By increasing the speed which his army traveled, Napoleon generated for himself a strategic advantage. He could use his tactics and deploy his troops faster than his adversary. Hitler used the same strategy in his “Blitzkrieg” campaign. The adversary was overwhelmed not by the use of sheer power but due to the fact that he could not organize and deploy all the required resources in order to mount a successful defensive. Just like an army, an organization, must operate in a rhythm that outmatches its competitors in order to achieve competitive advantages that lead to increased performance. Companies must de-

ploy their products faster, they must implement their strategies faster, they must ascend quicker in the international market and have to react faster to environmental factors faster than their competitors. Of course one may say that these things are totally evident due to the fact that being better overall than a competitor is a fundamental law of free markets. But in economy, just as in physics for example, the hard thing is to establish a benchmark. Being better than the established benchmark company or having better results than average market indicators is no solution. Often in traditional economic analysis the benchmark is more or less an average market indicator. As a benchmark, an average value is a safe choice but it is definitely not the best choice. If a company decides that having better results than the given market average is sufficient, it will rule out the possibility to establish higher goals than the best known competitor.

2. Napoleon organized his army in the old Greek phalanx manner, self sufficient combatant units formed from citizens from the same town, making them both flexible enough to deal with various threats and strong enough to hold well on their own. The ancient Roman Empire had a similar army organization, the famed roman legions were formed into cohorts- archer cohorts, infantry cohorts, and engineer corps. About two hundred years ago, Adam Smith elaborated a theory in which he stated that the labor division is the most efficient way to organize workers. A hundred years ago, companies used the model by organizing a company according to functional criteria. There are accountants that work in financial departments and technicians that work in operational departments etc. Just like the roman legions of old, 70-30 years ago a company would organize its activities. But as the development speed of a company rises, as more and more actions are performed outside national borders and as the globalization phenomena manifests itself more and more, new organization systems are required, more flexible sys-

tems and the Adam Smith model becomes obsolete. Multifunctional units are required in order to meet the demands of the ever-changing business environment. Napoleon used such multifunctional, multitasking units, units that had enough know-how to see the bigger picture, objective enough to have a rigid perspective upon the tasks at hand and flexible enough act as fast as it was required.

3. Napoleon obtained supplies for his army from his immediate surroundings instead of bringing supplies along. This fact contributed to the fast movement pace of his army. The disadvantage consists in the fact that his soldiers were forced to steal from the local population, which in turn caused unrest. But the manifestation of these problems was in the long run and he could deal with these in due time. The short term advantage surpassed by far the long term disadvantages. Today companies rely less and less on the classic “optimum supply quantity” model. The usefulness of the “Just in time” (JIT) method is sustained by reduced inventory costs. Of course the disadvantage that a company now depends on its suppliers makes this method unsuitable for some companies but just like Napoleon that had to maintain constant pressure upon the local inhabitants, a company must use every possible economic and juridical mean to maintain ties to its suppliers. Today, supply chain management is a critical part of a company’s activity portfolio, international and national suppliers alike form a complex network which must be properly managed.
4. Striking at an enemy’s supply lines represents a basic flanking maneuver. It is efficient because it eliminates the need for a direct confrontation. A successful attack on a poorly defended supply line means most of the time, the enemy’s annihilation. Today, this is done in business situation through the introduction of exclusivity contracts. By example, “Pepsi” has an exclu-

sivity contract with “Pizza Hut”, which means that “Coca Cola” is automatically removed as a competitor for the given segment.

3. Main principles

As military strategy preceded firm strategy, it is natural to state that firm strategy took the majority of its main concepts from military strategy. Because the two had an independent evolution, an orientation demarcation took place regarding the concrete applicability. Albeit in passing years the problem of adapting a series of mainly military techniques for business use was raised, the time’s economists quickly undermined those ideas. They stated that war and conflict, in general, lead to a decrease in economic value of activities and that the only way to obtain prosperity is to develop a company and direct its financial and human resources towards production and internal development.

Nowadays, we consider things in a different manner. Even though the main objective of every company remained the same – to obtain profit, it is well recognized the importance of the business environment. This implied that in the center of a company’s view, competition became one of the most important factors. Today, the interactions between economic agents became more and more intense, leading to firm cooperation, strategic partnerships, firm clusters and firm networks. These partnerships share much with military alliances, both from operational and functional points of view (alliances confer psychological safety, ensure easy access to resources and information shared between group members, and provide an overall economic strength).

However, these alliances created a new favorable context for the development and application of aggressive military strategies. The fact that peaceful strategies had worked, implied that there is a possibility that offensive strategies could be used successfully. Thus, military strategies were successfully applied in marketing situations, the managers that adopted this aggressive way to run their business had results

that exceeded expectations regarding market share. If we take into consideration the simple aggressive human nature, we can explain the aggressive behavior of companies. An alliance is able to provide a whole lot of opportunities, but it cannot provide the power possessed by a market leader. Using aggressive military strategies aimed towards the competition, some formidable competitive advantages could be obtained by firms that decide it is best to defend their market share, and by companies that consider the attack the only solution. Considering the free market, using military strategies does not represent a time consuming process because the concepts taken into consideration are clear-cut. The manner of employment these concepts stand for the *innovative* matter.

In the late 80's, experts from the firm strategy field, realized that there was a vast knowledge "database" dating some thousand years that they barely analyzed. They turned their attention towards military in order to find a series of principles that could be used in order to elaborate firm strategies. A series of well-known works like "The art of war" by Sun Tzu and "On war" by Carl von Clausewitz became instant classic business books. From Sun Tzu we can learn the tactical part of military strategy. On the classical principle of strategy "the advantage of the first move", Sun Tzu said "In general, the one that occupies the field of battle first and awaits the enemy is tranquil, and the last to arrive, rushes to the fight and is both mentally and physically tired". From von Clausewitz we can learn the unpredictable dynamic nature of military situations. Von Clausewitz considered that in chaos and confusion situations, the strategy should be based on flexible principles. The strategy does not derive from a formula or rule of thumb, but from adapting current actions. He called this concept "friction" (events that unfolded minute by minute).

Basically there are three types of military strategies that can be applied in business scenarios: 1. Offensive strategies, 2. Defensive strategies and 3. Guerrilla strategies.

Offensive strategies represent that kind of business applicable strategies that are designed to allow a company to reach an objective usually in spite of its competitors. There are four basic principles to follow in order to launch a successful attack:

- a. The adversary's strength must be assessed, by analyzing the amount of resources a defender can mount. Only one target at a time must be attacked at any given moment.
- b. Weaknesses in the enemy's position must be identified and attacked. Always take into consideration how much time it would take the defender to close the gaps.
- c. The attack must be launched on a narrow front as possible. While a defender must spread resources to defend its entire territory, the attacker may choose to attack any point.
- d. The attack must be carried out swiftly. The surprise element weights more than brute force.

The main offensive strategies can be categorized in three groups:

- A. Frontal assaults – it implies a head on attack in which all the attacker's available resources must be mobilized. In business situations this involves that all the company's departments must be made ready for the next course of actions, the use of extensive re-engineering is advised. Usually such attacks are being started by extensive marketing campaigns with the end goal of stabilizing a large market sector. In practical terms frontal assaults would be difficult to execute because of the high level of financial resources involved in the process and its success is conditioned by a series of market factors like: market homogeneity, low customer loyalty, low product differentiation and the fact that the targeted company must have limited resources at its disposal at the time of attack.
- B. Dispersed attack – it represents a more subtle approach on attacks. It means that the defender's position is surrounded and attacks are made in selected weak spots. By releasing a set of products similar

to the defender's products. The products should be placed on different market niches, thus making the market share the target and not the products themselves. The attacker actually would attack market sectors that are not under the defender's control but are very similar. This form of attack can work if the market is very divided and several market sectors are poorly disputed. Although the amount of involved resources is far less than in the case of frontal assaults, the attacker must still muster enough resources in order to operate on several segments and have superior organizing ability.

- C. Flanking maneuvers- it means applying pressure on the sides of an enemy line in order to modify its orientation. The gains of the attacker materialize through the chaos caused in the enemy lines. Thus direct confrontation is avoided and casualty count is low. The main disadvantage of a flanking maneuver is that the attacker himself becomes vulnerable leaving his centre exposed. In marketing such a maneuver can be performed on a market that the competition doesn't consider critical. Techniques like subtle advertising public relations and direct advertising.

Defensive strategies represent a kind of strategy designed to protect one's interest, maintain profitability in order to sustain other related activities. There are five basic rules to be followed when mounting a defense:

- a. An attack must be countered, whenever possible, with the same amount of strength.
- b. Every important asset must be defended.
- c. Always evaluate the strength of possible competitors.
- d. The best defense resides in the courage to attack your own positions.

The last of the four principles, refers to the fact that in any market products and services have a decent degree of similarity. A company

that decides to constantly improve its products/services, knowing that new products will replace older ones, will obsolete its previous products/services but also all the products similar to those offered by the competition.

Types of defensive strategies:

- A. Fixed defense – it implies the fortification of a defendable location. This defense isn't very efficient due to the fact that the defender is highly immobile and thus his position is known. A fortified defender will often just wait for an attack to happen. In business situations, a company that focuses on customer service, customer loyalty, determining repeated buyouts, is using fixed defenses. This strategy can be used if the market is homogenous.
- B. Mobile defenses – it represents moving resources from one place to another and the constant change of used tactics. A mobile defense is difficult to attack due to the fact that it has a flexible mechanism and it becomes active only in case of an attack. In business this form of strategy can be implemented by modifying existing products, repositioning products, changing the advertisement orientation. On a managerial level it implies a flexible organization on highly developed functional divisions.

Guerilla warfare represents a distinct way on war approach. This type of war means weakening the enemy through a series of minor attacks. The guerrilla forces, instead of organizing themselves in compact groups, which are divided into small taskforces that attack in a selective manner enemy weak spots. The general frame in which the strategy progresses is represented by a succession of attacks and withdrawals. It is a well-known fact that guerillas do not win wars; instead, it determines the adversary to loose it. The efficiency of guerrilla warfare resides in the series of strong points, as follows: a) due to the fact that a full confrontation with the enemy will never take place, the guerrilla will conserve its resources; b) a guerrilla force is very flexible and can

be adapted both for offensive and defensive operations; c) a guerrilla is hard to counter using classical means.

In business, guerrilla warfare could be used in various ways: 1) advertising that compare own products with those of the competitors, 2) short term alliances 3) selective reductions in price 4) negative publicity.

Guerrilla tactics are very easy to use by small firms that naturally have high flexibility and have limited resources. A small firm can easily abandon market sectors, can easily change their product range, and from a managerial point of view, can easily change its objectives. If we consider a large company that runs mainly on efficiency principles, it will be unproductive for that company to make efforts to remove a small company that tries to expand, because the expenses involved in the process will surmount by far the short and medium term potential revenues. Small firms also have a major advantage over large companies regarding client proximity. A small firm is far closer to its clients and can interact with them on a human level. This in turn creates opportunities to make low cost advertising and even zero cost advertising.

4. Brief explanatory case study

A very important economic sector stands for the mobile telecommunication market. After 1997, this sector developed into a significant part of the Romanian economy by the entering on the market of large international mobile telecommunication companies. This study will consider a company from this sector – Vodafone, which is a serious contender for the market leader position.

Vodafone is the second largest mobile telecommunications company in Romania. It has at its disposal sufficient financial resources in order to launch strong attacks on the market currently occupied by Orange and sufficient specialized know-how in order to perform flanking manoeuvres on the more vulnerable segments controlled by its competitor. Considering the current possibilities, it is normal to present two

types of military doctrines that would be appropriate in the given scenarios. There are two ancient Chinese doctrines that could be applied successfully: The “killing blow” and the “patient hunter”. The first doctrine will be assimilated to the frontal attack and the second one will be assimilated to flanking manoeuvres.

By having at its disposal a large array of possibilities, Vodafone can adopt versatile courses of action that will make for its competitors that much harder to anticipate its next move, making very difficult for Orange to predict when the next offensive will start and with what strength. On the other hand, having such a great arsenal of possible actions implies some disadvantages tied to it. Firstly, the sheer fact of having multiple choices lengthens the time of identifying the best option, and because time is the most important resource an attacking company has at its disposal, it represents a serious disadvantage. Secondly, another inconvenience resides in the fact that in order to decide upon the best course of action the criteria upon decisions will be taken, must be kept to a minimum. In every case the only two criteria considered must be efficiency and effectiveness. Taking into consideration more criteria than the before mentioned two, will lead to a different selection and a hard implementation from an operational point of view.

The “killing blow” doctrine implies attacking the adversary by super concentrating all available resources into one destructive mass. From a military point of view, this form of approach is highly cost-inefficient; the waste of resources and time is very high in the planning phase, and the total amount of resources involved in the attack process is often indeterminably high in real terms. The only short term advantage presented by this approach is the reduced time of the conflict itself, having perhaps the shortest duration possible. The attack is violent and directed towards all key points held by the adversary. Long term advantages of using this method reside in the fact that if the attack is successful, the defender may not recover the inflicted losses. This type of strategy can only be used only by large companies that can spare the

necessary resources. For a large company the ratio between the importance of time as a resource versus the importance of financial resources is greater than one, meaning that time becomes more important as a company gets larger. A smaller company values money higher than a larger one. Wasting precious resources in a decisive attack can have dire repercussions, and the company may even go bankrupt.

In order to perform a successful “killing blow”, Vodafone must make several small alterations to the designated plan without forgetting the number one rule” attacking in a focused manner”. Orange is a formidable defender; it has large financial resources in order to mount a great defence, it has sufficient know-how in order to efficiently manage involved processes, and has a great number of specialised experts in different fields capable of making plans and forecasts. This is why a single massive attack does not fare well. But if a series of fake attacks will be performed in order to hide the true intention the odds of success will be improved. Let’s assume that the objective of the attack is to obtain supremacy in the post pay segment of the market. It is a vast and difficult market. It represents a good target but odds are that as soon as Vodafone will launch a new offer in order to attract consumers, Orange will be ready to make a counteroffer that is more consistent, designed to protect its customers. Thus all the work directed towards advertising, planning, human resources, finding and allocating funds will be in vain. But if Vodafone launches offers towards the prepay sector of the market, for example, benefits for students, or the possibility for senior citizen to make instalment payments, without trying to best Orange offers, they would manage to make a decent diversion. With these minor attack aimed towards Orange products, the true large attack against the post pay market is more likely to succeed.

There are several particularities of the “killing blow” doctrine that must be taken into account. First of all one must have a concentrated vision upon the objective. It is necessary to follow through only the main objective, everything else goes to second place. The effectiveness of this approach is critical because the objective must be fulfilled at all

costs. The main attack must be launched only towards the designated market. If during the operational stage, other opportunities become visible, they must be ignored. Through a decisive attack either products or entire market segments must be conquered. If the defender loses in the battle important products or loses an entire market sector then his profit will be reduced significantly. Also, when Vodafone decides to undertake decisive actions against Orange, then any attempt from other competitors to attack Vodafone's positions must be again ignored. Given the reduced time of a decisive attack, Vodafone can focus later to counter eventual raids made by other competitors.

Another doctrine that can be applied in the case on Vodafone is the "patient hunter". The doctrine represents a more elaborate version of a classical flanking attack. The doctrine maintains the advantage of a flanking manoeuvre – the low consumption of resources, both in the planning phase and operational processes. Also the planning phase has low time consumption attributed. The flanking attack has high opportunistic characteristics and it's based on efficiency. But as the name of the doctrine suggests, it is very time consuming. Basically the attacker adopts a passive stance, maintaining a low profile and waiting for the defender to commit a mistake. On a conceptual level, by using this strategy, the aim of the attacker is not to kill the prey but to injure it and by doing so this will cause the victim to commit more mistakes leading to more injuries. On a long run the defender will eventually give in and surrender.

However there is one flaw in the use of this strategy that resides in the fact that the prey must commit exploitable mistakes. The attacker cannot determine the defender to commit mistakes but he can lure him into a trap, thus encouraging the defender to take a course of actions favourable for the hunter.

When using this strategy, an attacker must consider the specifics of the doctrine; Vodafone must survey the entire mobile telecommunications market, not only the sectors controlled by Orange. The overall market

vision will provide more sources of opportunities. Finding weak spots in an enemy defences is not the easiest thing to do, but it's the "test of fire" that every army or company tactician must pass. An aggressor cannot establish to attack the vulnerable "X" area of the defender because the point it is not visible. The best thing to do is to wait for an opportune moment and seize all he can get. Even though the flanking attack is characterised by high efficiency and opportunity, given that Vodafone is a large company, it can establish more precise and elaborate objectives in the way that some areas can be considered more important than others.

If frontal attacks are aimed towards products and market segments, the flanking attack is more discreet and aimed towards the defenders customers. If we consider that Vodafone intends to attract a series of large corporate consumers without the use of discretion, its efforts will thwarted promptly by Orange. A subtle attack carried out with low resource consumption can succeed where large shows of force fail. There are two characteristics that a patient hunter must have. First he must have all the required patience to wait for the victim to fall into the trap and second, he must elaborate a trap that doesn't raise suspicion. What trap should Vodafone use? What possible mistake could Orange commit? It's pretty simple – it's the mistake that no defender should commit – to come out of the defended position and attack. About important corporate clients it is easy to see that Vodafone also has some important customers that Orange would most definitely like to call their own. By making Orange believe that Vodafone is not paying attention as it should to their own customers, Orange will fall into the trap believing it has a chance of attracting some customers. Meanwhile by preparing a complex offer for Orange's customers who should include lower prices, custom products and dedicated assistance, a trap is set. If the plan succeeds, Vodafone will have a small window of opportunity to launch its offers. Even if no Orange customer is persuaded by the offer, at least there is a greater certainty that future attempts will have greater odds of success due to the fact that from

that moment on, Vodafone services will represent a solid alternative for Orange products.

5. Conclusion

Applying military strategies in business can materialize in the future as a new economic discipline, having its own methodology and using its own concepts. The possibilities of applying military strategies in a company are limitless, just as there are infinite ways of elaborating a battle plan, an infinity of ways to organize an attack, all of these based on a series of fundamental rules. A good military strategy starts from the proper use of tactics; a company's strategy should always start from the real market conditions; in this way F.E. Adcock stated "wars are sometimes won by generals but battles are always fought by soldiers and lieutenants".

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New Public Administration Structures after Romania's EU Integration: the European Agencies

Radu Șerban

I. European agencies – harmonising means on the European single market

The European agencies, specialised bodies affiliated to the European Union institutions, have been established to support the member states and their citizens to adapt to the European norms, to transpose and respect the *acquis*, but also to benefit from the single market de-regulation.

No matter if private or state owned, goods or services suppliers, importers or exporters, larger or smaller, the Romanian companies will more and more have to deal, in developing economic operations on the internal single market, with the European agencies, as forms of public administration.

Competence delegation

The core of partial delegation of competences stems from the word *agency* itself. National agencies delegate their competences upwards, to the agencies that provide Union-wide coverage, whereas the European Commission delegates downwards, to the same agencies, which want to be less institutional.

Even if the European agencies are not decision-making bodies, they are important to the Romanian economic operator. Those who ignore them diminish their chances to be successful on the European single market.

A few examples are clarifying.

The recently established *European Chemicals Agency (ECHA)*, based in Helsinki, ensures consistency in evaluating the chemical products with a view to registering them, and it offers opinions and recommendations as far as the authorisation and restriction procedures for some chemicals are concerned.

European Aviation Safety Agency (EASA) is in charge of certifying various types of airplanes, components and subassemblies throughout EU. A Romanian producer of aeronautical equipment cannot ignore it if it wants to have access on the single market. EASA can initiate legislative rules and provides technical expertise to the European Commission and to the member states.

European Food Safety Authority (EFSA) provides the European Commission with objective scientific recommendations regarding all the stages in manufacturing and distributing food products. Due to the fact that EFSA assesses the risks involved by the food chain throughout the entire “route” of a product (the so-called product “tracing and tracking”), it can have, through its activity, an impact on the Romanian food companies.

Intelligent Energy Executive Agency (IEEA) can guide a Romanian company that is interested in using renewable energy, by offering access to the European funds allocated to this field.

Community Plant Variety Office (CPVO) is useful for the farmers who want to grow genetically modified organisms as this agency provides the European Commission with scientific approvals to new plant varieties.

Translation Centre for the Bodies of the European Union (CdT) is becoming more and more interesting for Romanians, on condition that the commissioner for multilingualism makes wise use of the phrase “the country I know best”, connotatively used by the impartial eurocrats.

European Maritime Safety Agency (EMSA) has a great importance to the companies that develop their activities in the maritime field, taking into account that 90% of the European Union foreign trade takes place on sea, including the Black Sea and the Danube. Besides consultative tasks, EMSA has recently received operational tasks to combat pollution.

European Medicines Agency (EMA) cannot be indifferent to a pharmaceutical industry as big as the Romanian one, in which the Ranbaxy Indian group has entered exactly for access to the EU internal single market.

Office for Harmonisation in the Internal Market (OHIM) deals with the EU trademark and the community “design” registration according to the international norms regarding intellectual property. The Romanian companies, which will break the intellectual property rights on the European common market, will be investigated by OHIM.

Community Fisheries Control Agency (CFCA), set up in 2005, coordinates the control and the inspections in the member states, Romania included, and it makes sure that the single fisheries policy is obeyed.

European Railway Agency (ERA) reinforces safety and interoperability of railways in the member states. The fact that the legislation will gradually be adopted with a view to establishing an integrated European railway area will force the big Romanian operators to cooperate with ERA.

These are only a few examples.

There are, of course, agencies with a reduced impact on Romanian companies, which are relevant for other sectors; for instance, European Defence Agency (EDA), European Police Office (EUROPOL), European Union's Judicial Cooperation Unit (EUROJUST), European Monitoring Centre on Racism and Xenophobia (EUMC) etc.

The advantages of an independent central agency

The first advantage for citizens, for contributors, but also for companies, is that of reduced costs. The agencies are usually financed through contributions, which means less money spent from the Community budget.

In terms of advantages for economic operators, the agencies avoid, on the one hand, the European Institutions rigidity and their possible excessive bureaucracy, and on the other hand, they eliminate the segmentation of norms on markets circumscribed by the member states borders, which otherwise would multiply the procedures of accreditation, evaluation and acceptance of the products on the market.

Hierarchically situated between the European Commission and the governmental authorities, *the agencies* often offer solutions for the processes of internal single market reinforcement, of legislative harmonisation, without creating the impression of a sovereignty transfer from the member states. In general, the agencies make the sectors they deal with more visible at a Pan - European level; the existence itself of a specialised agency proves that the policies are focused on that market segment.

As far as the enterprisers are concerned, the agencies very often reduce the business costs. If, for instance, a Romanian company registers its new chemical product at ECHA or the medicine at EMEA, it makes its way into all the 27 member states, without having to pay registration fees in every single member state.

As for the European Commission, the agencies represent a big advantage in the sense that they take over the technical tasks. Thus, the European Commission has to deal only with its basic tasks.

The European agencies' drawbacks

The agencies are not a panacea for the harmonisation of the European single market. Many times they lack the power or the instruments to persuade the member states to apply the European legislation. Some other times they are not sufficiently held responsible for not accomplishing their own tasks or they do not prove that they serve the member states and that they are their “property”. As usually, the administrative structures tend to expand, to encourage bureaucracy, to obtain privileges.

Less relevant for the economic operator, the agencies are not so representative for the idea of integration. After they have settled down in various European cities, the agencies forget sometimes to fly the European Union’s flag, and the people who visit them have no idea that they appeal to the services of a European Union structure.

Decentralisation, the very essence of the European agencies, becomes devoid of content when their managers try to go beyond their status and take up executive roles, in order to justify certain organisational structures.

Another drawback brought about by agencies is the risk of doubling the tasks of some national institutions, if the procedures simplification process is not watched. As long as a state does not want to recognise the evaluation made by the European agency for some products, it invents new bureaucratic “filters”, and the economic operator has to make a double effort.

A possible European agency in Romania?

Since most of the member states host a European agency, Romania has every right to wish the same thing.

On 29 January 2007 the European MP John Bowis was explaining at “*Friend of Europe*”, a European think tank in Brussels that during his previous visits in one of the two new EU member states, he was suggested establishing, in that state, a European agency, not an ordinary one, but an imaginary “Agency of Mental Health”. Leaving aside the sarcasm that could be sensed in the MP’s voice, his commentary is a proof of how big the temptation is for any of the member states to host such an agency.

Even the proximity of such premises can be beneficial for the economic operator, plus the jobs it creates, and also the opportunity for the interested companies to communicate with the agency’s employees. We can notice how the lobby made by companies and employees has gradually attracted some agencies in the countries with a specific interest.

Pragmatically speaking, a question arises: *how can the European agencies help the Romanian companies?* In a free market economy, the state, partially replaced by the European regulators, has to offer equal opportunities for a loyal competition to all companies. The companies need a healthy business environment, which promotes competitiveness. Initially, if the regulators can’t do too much good in this respect, at least they shouldn’t do any harm! From this perspective, a ***European Agency of Integrity*** could be useful for the European companies, be they “*societas europea*” (SE) or under national jurisdiction. For instance, an independent agency, which has enough competences and instruments at its disposal to prevent ex high officials from getting to the top of some companies they had been working with towards the end of their mandate. An agency able to separate economy from politics, a situation also noticed by the analyst Martin

Wolf (FT/31 January 2007): the global economy is doing very well, but the politics hinders it.

If this is only an imaginary agency, there is at least one on its way of coming into being, which Romania could be tempted to host: ***The Agency for the Cooperation of Energy Regulators***.

II. The European Agency of Regulation in the Field of Energy

The European Commission suggested, in September 2007, the establishment of an “Agency for the cooperation of energy regulators”, abbreviated ACER. Its official birth certificate will consist of a Regulation to be approved by the EU Parliament and Council.

1. The Draft Regulation on setting up the Agency

Presented by the European Commission (E.C.) under the number COM (2007) 530, the draft contains enough details about the future Agency, in order to raise the economic operators’ interest in the European energy market. We will approach only a few of them, which are potentially of interest to Romania.

The political motivation for the E.C.’s approach is identifiable in the first sentences of the project’s explanatory memorandum: “*Electricity and gas are at the heart of Europe’s well-being. Without a competitive and efficient European electricity and gas market, Europe’s citizens will pay excessive prices for what is one of their most fundamental daily needs*”.

A few steps that preceded the idea of ACER are worth mentioning. In October 2005 the European summit, at Hampton Court, called for a “European energy policy”. On 8 March 2006, the E.C. published the “Green Paper” of the European energy policy and on 10 January 2007 E.C. released the paper “*An Energy Policy for Europe*”. The 2007 Spring

European Council invited the E.C. to suggest further measures, related to the following specific topics:

- the separation of production from distribution;
- the harmonisation of the powers of the national energy regulators;
- the establishment of a mechanism for cooperation among national regulators;
- the creation of a mechanism meant to coordinate the networks functioning, including their security;
- greater transparency on the market.

The third point above was the starting point of the idea of the *European agency for the cooperation of energy regulators*.

The aim of the Agency, in accordance with the E.C.'s document, is to supplement, at a community level, the activities developed by the national regulators in the field of energy. It has to guarantee that the regulating functions exerted by the state authorities at a national level, in accordance with the directives 2003/54/EC and 2003/55/EC, are appropriately coordinated and, if needed, completed at the EU level. The Agency has to monitor the cooperation among the transport system operators in the electricity and gas sectors, as well as the completion of the tasks of the European networks of transport system operators for electricity and the European networks of transport system operators for gas. The final beneficiary of this monitoring will be the **internal market**. The agency will have to have competences to transmit some non-binding guidelines, which are not compulsory for the regulators and the market operators, with a view to an effective good practices exchange.

The agency will also have a consultative role, between the national authorities and the Commission. It will have to grant the players on the energy market the certainty they need for their investment-related de-

cisions. Thus, the Agency will contribute to a more substantial set of rules with a view to deepening the energy market integration through a more efficient inter-state trade.

ACER will have to be a watch dog for the total independence of the national regulators' action in relation to any interest on the market, without any instructions from any government or any other interference of any public or private entity.

According to the Draft Regulation, in order to complete its mandate, the Agency must be independent and it must benefit of the necessary technical capacities, transparency and efficiency.

The Agency is “*a Community body with legal personality*” and can issue the following ***types of documents***:

- notifications addressed to transmission system operators;
- notifications addressed to regulatory authorities;
- notifications and recommendations addressed to the Commission;
- individual decisions in specific cases.

2. The Agency's Administration

The Agency is headed by a *director*, an *administrative board*, which consists of 12 members, six appointed by the Commission and the other six by the Council, with a five-year mandate, which can be reconfirmed only once. A *Board of Appeal* is called any time needed, which makes decisions through the qualified majority of at least 4 out of its 6 members.

It can bring an action before the Court of First Instance of the Court of Justice in order to contest a decision made by the Board of Appeal.

It also benefits from all the privileges and immunities of EU institutions.

A schematic image of the Agency has been described by an EC expert at the “European Voice” Conference on 7 February 2008, in Brussels¹:

<i>Functions and methods of implementation</i>	
<p>The main functions:</p> <ul style="list-style-type: none"> - it provides a framework for national regulators to cooperate - it supervises the cooperation among the transmission system operators (TSOs) - it has individual decisional powers (e.g. requests for exceptions and regulating conditions among the member states) - it has an advisory role for the Commission - it has the power to adopt optional orientations 	<p>Methods of implementation:</p> <ul style="list-style-type: none"> - the Administrative Board - the Board of Appeal - 40-50 employees - annual budget: € 6-7mil.

3. The first reactions to the EC proposal of setting up the Agency

On 24 January 2008, the Draft Regulation was discussed within the *Industry, Research and Energy (ITRE)* Committee of the European Parliament.

The **first observation** made by the MPs refers to the danger of bureaucracy. Unless it is granted sufficient regulatory power, independent from any other exterior influences, the Agency risks to make the current procedures even more bureaucratic, and thus it does not con-

¹ “Gas and electricity markets: working for consumers or national champions?”, Walter Tretton, European Commission, DG Competition

tribute to the main aim that animated the initiators, which is market deregulation.

The **second observation** refers to the fact that ACER will not actually have any direct regulatory authority at national or European level. The role of the Agency is only restricted to consolidating the national regulators and their independence. Thus, an enhancement of the investments in the inter-state transmission of energy is attempted.

The **third observation**, maybe the most important one, urges to more courage in deregulating the market, because the measures in the “third energy legislative package” are not enough to create a *single European market of energy*. In this sense, some of the deputies requested that ACER should be more than a advisory body, with clearer competences, even in setting the prices for electricity.

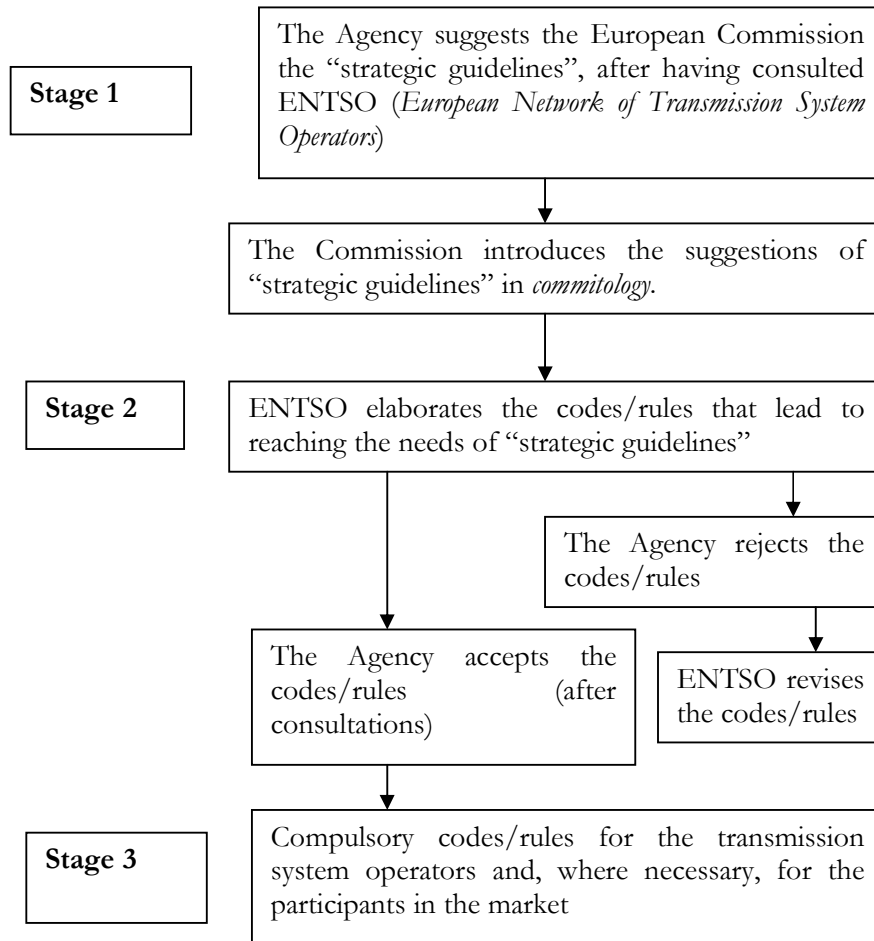
The consolidation of ACER powers beyond the EC proposals faces, at least, two obstacles:

- the political disagreement among some member states;
- the EU treaties do not allow the European Commission to grant a body powers the Commission itself doesn't have.

Some MEPs request that ACER should have the capacity to solve the problems related to the unfair, discriminatory or ineffective access to the network that go across the national boundaries. ACER is even wanted to be able to impose sanctions if the barriers against inter-state commerce are not eliminated.

However, as previous experience shows, it is expected that the Agency be granted at least the powers stipulated in the EC Draft Regulation.

4. The Agency in the scheme of the regulatory bodies in the field of energy

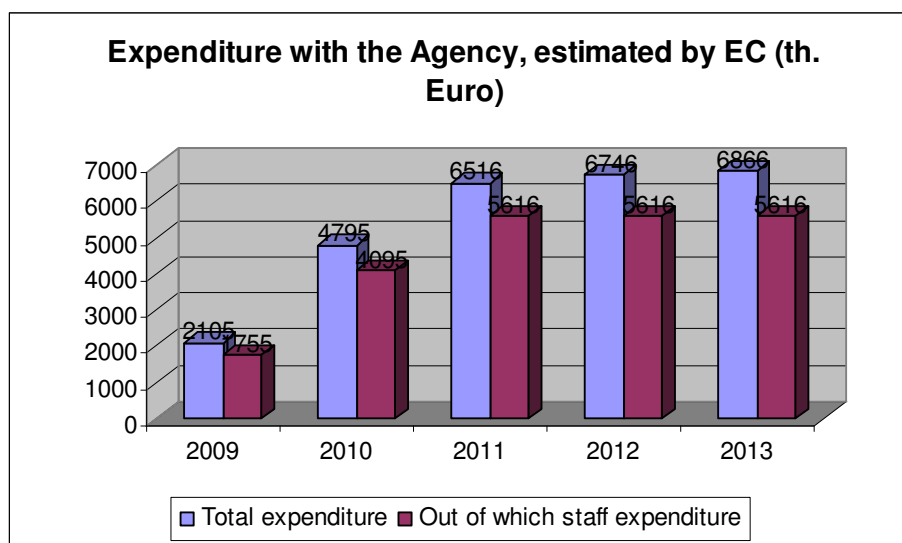


Source: adaptation after "Bundesnetzagentur", the German federal agency for electricity, gas, telecommunications, postal services and railways

5. The Agency's budget

The budget proposed in the financial description, annexed to the Regulations, is based on an estimated 48-person staff and comprises expenditure associated with buildings, and also movable, operating, administrative and mission expenditure.

<p>Agency's incomes consist mainly of:</p> <ul style="list-style-type: none"> - a subsidy from the EU budget; - taxes paid to the Agency for granting derogations - voluntary contributions of the member states or of their regulators. 	<p>Agency's types of expenditure are:</p> <ul style="list-style-type: none"> - staff expenditure; - administrative expenditure; - infrastructure-related expenditure - operating expenditure
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Source: the author's bar chart, following Annex 1 to COM(2007)530 final

The sums allocated for the staff have been calculated in accordance with the "key" used for the EC's staff expenditure, namely € 0.117 mil

a year for each person. Multiplied by 48 people, it reaches a maximum annual amount of € 5.616 mil, to be allocated starting 2011. A number of premises-related and administrative (mail, telecommunications, IT etc.) expenses are added.

The main staff expenditure will be allocated in accordance with the following progressive scheme:

No.	Semester	Recruitment	Total staff
1.	I – 2009	+ 10	10
2.	II – 2009	+ 10	20
3.	I – 2010	+ 10	30
4.	II – 2010	+ 10	40
5.	I – 2011	+ 8	48

The expenses related to purchasing movable goods will reach € 350,000 in the first two years, varying in the years to come according to the facilities offered by the host state. The operating costs will be added: meetings, studies, translations, publications and public relations, which will add up to € 1 mil a year. Trips inside and outside the EU (transport, accommodation, daily allowance) are estimated to be as much as €150,000 when the Agency becomes fully operational. The estimations are based on the current mission-related expenses attributed to the Directorate General of Transport and Energy (DG TREN), within the European Commission.

6. Agency's headquarters

The widely known competition among the member states for hosting a European agency relies on the obvious advantages offered by such premises: well-paid jobs, institutional tourism accompanied by the corresponding export of services, visibility among the member states and

even worldwide, using EU funds in the host country, bringing the decisional power closer to the host country etc.

The ACER employees, in their capacity as European Union clerks, will actually benefit from the same privileges as the European clerks in Brussels, Strasbourg, Luxembourg or in any other European Union city which the European institutions and agencies are based in. The Poles have made serious lobby to host a prestigious agency, with great future perspectives: *Frontex*. Earlier, the Finns had successfully fought to host the European Chemicals Agency (*ECHA*). A similar competition could have been observed, throughout the whole European integration process, in the case of the other agencies.

Bucharest could qualify for hosting ACER. Naturally, priority will be given to the new member states, and our country is one of them. Romania would also have the advantage of a solid energy-related potential, especially hydro, which provides it with a good positioning in the area of renewable energy sources. Its geographical position, bordering on the Black Sea, on the route of the energy transit networks from Central Asia to EU, qualifies it as a country of interest for the European energy-related policy. Moreover, still exploitable gas and oil resources, its long experience in the hydrocarbons industry, as well as the remarkable dimensions of the internal market which places Romania, in demographical terms, among the largest states of the Union, all these, plus the lack of European institutions or agencies in our country, make Bucharest eligible among the potential applicants for ACER premises.

I would add the high degree of privatisation and unbundling in the Romanian energy sector, which is above the EU average, and especially above the level of privatisation in some of the largest member states, which, somehow paradoxically, have participated in the privatisation in Romania with state-owned companies.

If the fundamental aim of the European energy market is to offer the consumers lower prices by stimulating competition, then ACER, as a

specialised agency on the internal energy market will be able to contribute to setting more accessible prices for the Romanian consumers, thus boosting their welfare.

The worst case scenario, that of applying, but failing to eventually host the agency, would offer the Romanian *eurocrats* an advantage in the future European negotiations.

However, a question could arise: does Romania have the necessary logistic capacity to manage such an agency? The answer is easy to give: a country, which hosted the francophone summit or NATO summit, which has world class administrative buildings and qualified personnel, can proudly hope for the status of ACER host.

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This paper on a reality of the community administrative structure, namely that of the *European agencies*, tries to raise awareness about the perspective of including, sooner or later, such structures in the Romanian public administration in a large sense, which come with their advantages and the mimetic effects they may produce, as a consequence of Romania's integration into the European Union.

Radu ȘERBAN, Ph.D.

Experiential Marketing vs. Traditional Marketing: Creating Rational and Emotional Liaisons with Consumers

Dainora Grundey

The purpose of this paper is to show peculiarities of traditional and experiential marketing and describe why experiential marketing is better way to understand consumer behaviour. Comparative analysis shows the main characteristics of traditional and experiential marketing. Traditional marketing characteristics are there: product functional characteristics and superiority, narrow determinate product categories, point of view to the consumer as a rational thinker, application analytical, quantitative and verbal methods, mechanical standpoint to the consumer "Stimulus- Reaction". Experiential marketing present these characteristics: orientation to the consumer experience, looking to the consumer experience holistically, point of view to the consumer as rational thinker and emotional too, exclectizm of methodical, "from Stimulus to Reaction". As we can see out of traditional marketing characteristics this standpoint to the consumer is insufficient, because it evaluate just one side of consumer behaviour: rational conduct so looking the biggest benefit from purchase. Meanwhile experiential marketing estimate both sides of consumer: rational and emotional, this standpoint to the consumer is more personal, individual.

Key words: traditional marketing, experiential marketing, product superiority, consumer, emotions, rationality.

JEL classification: M31, P23.

Introduction

Nowadays then the world is very quickly change, coming new technologies, communication, comes changes in to the marketing too. In the Great Britain, USA and similar counties markets are overfill with products and services. There are big competitions so principles and actions of traditional marketing do not work. How attract new consumers, cause? These opportunities have experiential marketing.

Some propositions of traditional marketing are discussed. In the traditional marketing commodity is understanding as accomplice of attributes. K. Lancaster expressed this standpoint the first time in 1966. Then this standpoint was developing by F. Kotler, T. Nagle. In the newest science literature we can find good description as a complex of characteristics and superiority.

Many consumer behaviour researches such as Kotona, Engel, Blackwell, Minard (1999) consumer estimate like rational thinker. This standpoint is based on concept of information remaking. This concept widely comes from cognitivical psychology.

Marketing-mix inventor Neil Borden (1964) asserts that united components in the marketing-mix are not. Marketing-mix theory was criticising due to its mechanical point of view (stimulus- reaction). Now is proved that between stimulus and reaction is process.

The notion of experience has entered the field of **consumption and marketing** through Holbrook and Hirschman's 1982 pioneering article. Twenty years after, this notion has gained ground to be recognised as important for what it can contribute to **marketing knowledge of the consumer**. As a consequence, it is the pillar of the so-called experience economy and **experiential marketing**. Building on Arnould and Price's well-known 93's "*River Magic*" paper on extraordinary experiences, marketers tend to engage consumers in a memorable way, offering them extraordinary experiences. For them, experiences provide consumers a way to engage physically, mentally, emo-

tionally, socially and spiritually in the consumption of the product or service making the interaction meaningfully real.

Empiricism – this is based on one's own experience, sensual perception guarantees reliability (Hollis, 1994). Experiential marketing includes much more than sensual and rational perceptions.

In 1982 B. Holbrook and E. Hirshman separate only experiential standpoint, but experiential marketing conception still not using. These scientists try to replenish rational consumer understanding with experiential point of view.

But only B. Schmitt (2001) totally separately divided traditional and experiential marketing.

The main purpose of the paper is two-fold, namely a) to demonstrate the evolution of the notion of experience applied in experiential marketing and b) to show why experiential marketing could be applied in theory and practice rather than traditional marketing.

EXPLORING THE NOTION OF 'EXPERIENCE'

For researchers in consumer behaviour, an *experience* is above all a personal occurrence, often with important *emotional significance*, founded on the interaction with *stimuli* which are the products or services consumed. This occurrence may lead to a transformation of the individual in the experiences defined as extraordinary.¹ Taking up the argument of sociology research in consumer behaviour considers experience as a central element of the life of today's consumer, a consumer who is looking for sense: "for the post-modern consumer, consumption is not a mere act of devouring, destroying, or using things. It is also not the end of the (central) economic cycle, but an act of production of experiences and selves or self-images..."²

¹ Arnould and Price, 1993

² Vezina, 1989, p 62

Life is to be produced and created, in effect, *constructed* through the multiple experiences in which the consumer implicates. As a consequence, a key concept developed along with experience is the one of immersion: the post-modern consumer is said to take pleasure “in being immersed in McDisneyfied banalities”.¹

Indeed, there is the recognition of a “growing quest on the part of the contemporary consumers for immersion into varied experiences” more and more conceptualized as “embodied experiences”. The roots of this so-called experiential consumption must be sought in the growth of services, for which the good that is purchased is an experience rather than a material object. Its main feature is to grant space to emotions. This leads to an experiential approach to the study of consumption which recognises the importance of variables that have previously been neglected: “the roles of emotions in behaviour; the fact that consumers are feelers as well as thinkers and doers; the significance of symbolism in consumption; the consumer’s need for fun and pleasure; the roles of consumers, beyond the act of purchase, in product usage as well as brand choice, and so forth”.²

In the experiential perspective, the consumption experience is no longer limited to some prepurchase activity, nor to some post-purchase activity, e.g. the assessment of satisfaction, but includes a series of other activities which influence consumers’ decisions and future actions. Consumption experience is thus spread over a period of time which, according to Arnould and Price (1993), can be divided into *four major stages*:

- The *pre-consumption experience*, which involves searching for, planning, day-dreaming about, foreseeing or imagining the experience;
- The *purchase experience* which derives from choice, payment, packaging, the encounter with the service and the environment;

¹ Thompson, 2000

² Addis and Holbrook, 2001, p. 50

- *The core consumption experience* including the sensation, the satiety, the satisfaction/dissatisfaction, the irritation/flow, the transformation;
- The *remembered consumption experience* and the *nostalgia experience* activates photographs to re-live a past experience, which is based on accounts of stories and on arguments with friends about the past, and which moves towards the classification of memories.

Thus, the consumption experience cannot be reduced to the sole *shopping experience*, e.g. the experience at the point of sale. This concept of shopping experience is based on work which since the 1970's has looked at purchasing behaviour at the point of sale and sought to go beyond the hypothesis of consumer rationality. This first revealed a type of consumer termed 'recreative'. Later, broader studies highlighted *hedonistic behaviour* in most consumers, so moving attention from the *utilitarian to the hedonistic value* of shopping.

For *marketing, design and economy*, an experience is mainly a type of offering to be added to merchandise, products and services to give a fourth type of offering which is particularly suited to the needs of the post-modern consumer. Indeed, there is a shared belief among these authors that the post-modern or "millennial consumer" is simply not what the ***rational model of marketing*** wanted her/him to be. Thus, for marketing, as Gupta and Vajis state, a good experience is 'memorable', if not 'extraordinary', allowing this consumer to exploit all his/her senses through the staging of the activity/physical support/social interaction triptych. This type of *experience produces emotions* (in marketing, emotional experience or emotion is often cited as the heart of the consumption experience) and also transformations in individuals. "Some industry experts argue that economic value now turns on more than a high-quality product or good service delivery: it turns on engaging customers in a memorable way offering them an experience, or even better, transforming them by guiding them through experiences. When offering experiences marketers are con-

cerned with staging the experience – making it memorable and personal”.¹

Experience, in this paper, is defined as *a subjective episode in the construction/transformation of the individual, with however, an emphasis on the emotions and senses lived during the immersion at the expense of the cognitive dimension*. Marketing, on the other hand, gives experience a much more objective (rather than subjective) meaning, confirming the idea that the result may must be something extremely significant and unforgettable for the consumer immersed into the experience.

Despite the existence of different experience typologies, it is the flow experience with its idea of total immersion or plunge which has most attracted marketing researchers, in particular those working on consumer behaviour, who, as Arnould and Price state, have compared it to the peak experience conceptualised by Maslow in the 1960’s with reference to religious ecstasy. The experience has also been compared to the epiphanic experience described by Denzin and to the extraordinary experience introduced by Abrahams. For Denzin, “epiphanic experiences rupture routines and lives and provoke radical redefinitions of the self. In moments of epiphany, people redefine themselves”.²

SHMITT’S APPROACH TO THE NOTION OF EXPERIENCE

It is very important to analyze Shmitt’s (he is the great initiator of experiential marketing) attitude to experiences. In particular, Schmitt takes issue with the features and benefits approach of traditional marketing. In this (traditional) model, consumers are thought to go through a considered decision-making process, where each of the features or characteristics of a particular product or service are seen to

¹ Arnould., 2002, p. 423

² Denzin, 1992, p.26

convey certain benefits, and these are all assessed by the potential purchaser (either consciously or unconsciously). However, for Schmitt, this is far too limited a way of viewing the purchase decision, with excessive emphasis on the rational and logical elements of the decision, and not enough (or any) on the emotional and irrational aspects involved in the purchase.

The alternative framework that Schmitt proposes is based upon two elements: strategic experience modules (which he calls SEMs), which are different types of experiences, and ExPros (short for experience producers) which are the various agencies that deliver these experiences. Experience marketing is the discipline of creating products and services that consider all elements of this framework. Schmitt identifies *five different types of experiences or 'strategic experience modules' (SEMs)*. These are:

SENSE: These are sensual and tangible aspects of a product or experience that appeal to the five senses of sight, sound, scent, taste and touch. Sense experiences are particularly useful to differentiate products or services, to motivate potential customers, and to create a sense of value in the mind of the purchaser.

FEEL: Feel marketing is devoted to inducing affect (i.e. the creation of moods and emotions) that adhere to the company and brand. Clearly, positive or negative feelings toward a product or service will influence the extent to which it is consumed.

THINK: The objective of think marketing is to encourage customers to engage in elaborative and creative thinking that may result in a re-evaluation of the company and products.

ACT: Act marketing is oriented towards the creation of experiences through behavior on the part of the customer, either privately or in the company of others. The goal is to change long-term behavior and habits in favour of the particular product or service.

RELATE: Relate marketing expands beyond the individual's private sensations, feelings, cognitions and actions by relating the individual self to the broader social and cultural context reflected in a brand. In other words, relate marketing plays upon the identification of self with the context and associations bound up in the product or service used.

These five different types of experiences (SEMs) are conveyed to individuals through experience providers (ExPros), which are vehicles such as:

1. *Communications:* advertising, external and internal company communications, public relations campaigns visual and verbal identity and signage, including names, logos, colours, etc.
2. *Product presence:* design, packaging, and display
3. *Co-branding:* involving event marketing, sponsorships, alliances and partnerships, licensing, product placement in movies, etc.
4. *Spatial environments:* which include the external and internal design of corporate offices, sales outlets, consumer and trade fair spaces, etc.
5. *Web sites.*
6. *People:* salespeople, company reps, customer service providers, call centre operators.

Figure 1. Shmitt's Experiential Grid

The Experiential Grid

ExPros

		communications	identity	touchpoint	co-branding	enrichments	web sites	presence
SEMs	SENSE							
	FEEL							
	THINK							
	ACT							
	RELATE							

Source: www.exmarketing.com, referred on 26/03/2008.

Interaction of SEMs with ExPros generates what Schmitt calls the '*Experiential Grid*': a comprehensive framework for considering all the ways in which experiences can be induced on the part of an actual or potential customer. The first two sections of the book are devoted to an elaboration of the underpinnings of this framework, which is conceptually illustrated in Figure 1.

Traditional VS. Experiential Marketing: comparative analysis

When we talk about experiential marketing superiority against traditional marketing, it's only theoretical preposition. But why experiential marketing is better than traditional marketing and what revolutionising experiential marketing doing that we have better opportunity in the best way to understand consumer behaviour. This problem may help

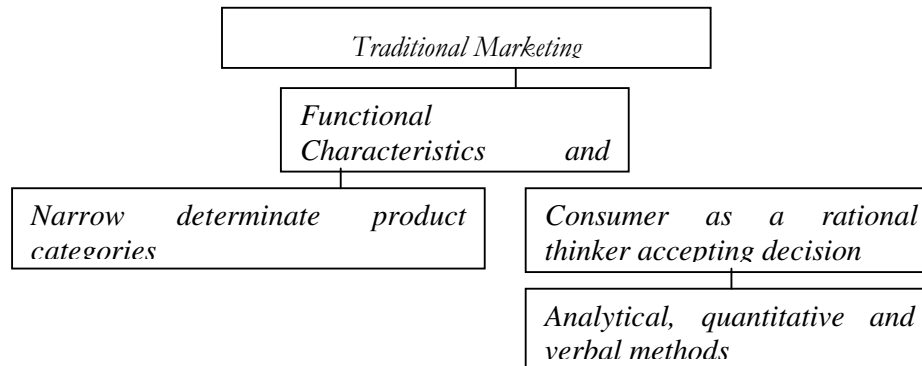
decide comparative analysis between traditional and experiential marketing. In this analysis we will see disadvantages of traditional marketing.

Traditional Marketing Defined

Bernard Schmitt (2001) like this describes traditional marketing: there are complex of principles, conceptions and methodology, working off by scientists, consults and marketing practices (Schmitt, 2001). In the traditional marketing principles and conceptions talking about product and its nature, consumer behaviour and competition wars. These things are using to new products creation, planning sales assortment and brands, projecting communication with consumer and doing returning actions to the competitors.

Traditional marketing and its four main characteristics that it is have by Bernard Schmitt (Figure 2).

Functional characteristics and superiority: Traditional marketing is orientated to the commodity functional characteristics and superiority. In the any market clients look some characteristics of the goods that have the biggest benefit for them. F. Kotler (1969) talking about goods characteristics emphasise that “characteristics add traditional goods function”. In the traditional marketing, marketing specialist have to know, that consumer interested no good as itself, but it’s characteristics, that have each of it. The first time this standpoint was expressing by Lancaster in 1966. He talks about products attributes, so individuals have different reaction to the same good because they gives preference to the good attributes.

Figure 2. Peculiarities of Traditional Marketing

Source: Schmitt (2001).

If we think that consumer choose product according to its characteristics therefore we differentiate products according to its characteristics too. Superiority appears from products functional characteristics. Superiority – this is consumption characteristics what wants consumer then he buys a product.

Bernard Scmitt (2001) asks, does the good is only characteristics and superiority? (Scmitt, 2001). We have opportunity to answer the question, only if we would like to consumer from both sides: rational and emotional.

Narrow determinate product categories and surrounding competitor limits: Traditional marketing looks narrow to the surrounding competitors and to the products too. Traditional marketing separated concrete goods and services. For example if we want separate Chinese restaurants as our competitors we turn one's attention to other Chinese restaurants. But

we may name all surrounding restaurants and bars, pubs, in generally all public-feeding institutions. Consumers want not only to eat or to have some benefit but also to get sense, feelings; they want to enjoy with internal atmosphere.

Consumer as a rational thinker accepting decision: Marketing and economic specialists value consumer purchase process like rational decision looking then consumer only wants to solve a problem.

J. Engel, R. Blackwell and P. Miniard (1999) separate seven consumer purchase process stages (Engel, Blackwell, Miniard, 1999):

1. Problem.
2. Search of information.
3. Estimation of versions.
4. Purchase.
5. Consumption.
6. Estimation of versions after purchase.
7. Release of the problem.

Traditional marketing says that consumer controls the situation and purchase is sensible action. This action consumer does then he wants to solve a problem.

Using analytical, quantitative and verbal methods: Traditional marketing is using analytical, quantitative and verbal methods. And instruments are using too to the making research.

In the traditional marketing all marketing- mix is orientated to the consumer, believing results according to this principle: “Stimulus- Reaction” (Van Vaterschoot, 2002). This standpoint is the biggest marketing-mix disadvantages, because this point of view is very limited, in the other worlds it is mechanical. We do not estimate other factors such as individuality of consumer, emotions, feelings and other.

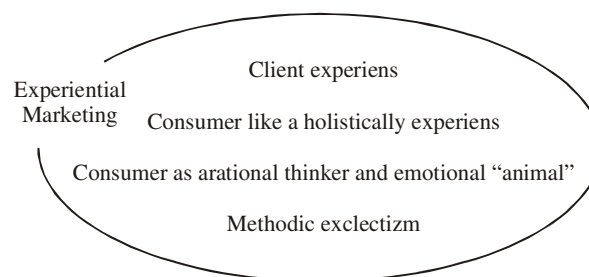
Experiential Marketing Defined

In our days consumer perceive goods characteristics and superiority, quality of good, positive brand image as them goes without saying. So this thins does not work, consumer is waiting such product, communication or company which wake his feelings, agitate his soul and mind. He wants such products, advertising and company, which will be orientated to him and corresponds his life style. Consumer wants that all these things raise experience (Scmitt, 2001).

Paul Postma looking over new marketing era related to the new technology, said that is going changes in the obtaining information about consumer, information rendering to the consumer- appears new technologies, new advertising opportunities. But technology and its new era does not work to the person and his behaviour (Postma, 1999). The author said that some methods we can change, but personal needs always are very important. People have inclinations and specific features, and these things do not change all over century.

Experiential marketing has also four characteristics by Bernard Scmitt (Figure 3).

Figure 3. Characteristics of Experiential Marketing



Source: Scmitt (2001)

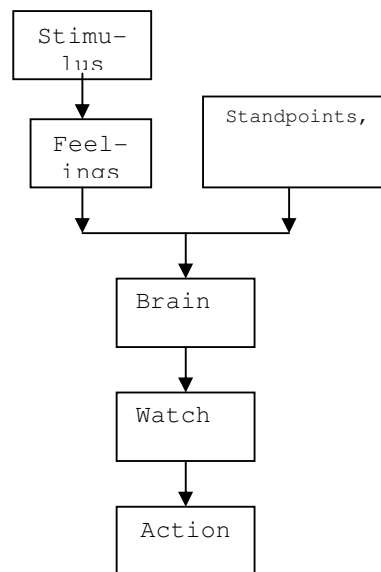
Client experience: At different from traditional marketing in the experiential marketing the main accent is client experience, which appearance when client benevolent or by force is in the determinate situation. Experience this is result of soul, mind and stimulation to the sense. Experience shows sensitive, emotional cognitive characteristics of the behaviour, characters, standpoints, and values, which are equalised with functional values.

Consumer like a holistically experience: In the traditional marketing we saw narrow determinate products and competitors; experiential marketing does not have personal categories for example shampoo, cream. Instead of we state “body and hair care in the bathroom”. Then we decide that products are in this using situation. Acceding products, its packing, advertising can awaken wish to experience those product using.

Consumer situation analysis and selecting more general product categories and competitors in the some frames allow understanding other possibilities in the market.

Consumer as a rational thinker and emotional “animal”: Consumer behaviour influence rational factors but emotional too. So consumer chooses his purchase following rational causes and his fantasies, feelings. Person is waiting that somebody stimulates him/her, agitate his feelings. Therefore, the traditional point of view is insufficient.

Methodical eclecticism: In the experiential marketing we have possibility to use many research methods. There is no one a methodological model and in its own research this marketing is eclectically. In the newest marketing theories we can see process between Stimulus and Reaction. This process is represented in Figure 4.

Figure 4. From Stimulus to Reaction

Source: Postma (1999)

Information assignment means make Stimulus which accept feelings and then assignment to the brain where is all points of view about reality. Coming impressions is changing by the brain and then formatted reception which help to reach some action (Postma, 1999).

Psychological standpoint: G. Foall (2002) analysing relation between marketing and psychology almost combine traditional and experiential marketing. He notes that talking about consumer behaviour is very important sensations before purchase, in purchase time and in using process (Foxall, 2002). But in this theory goods characteristic is very important too.

Results

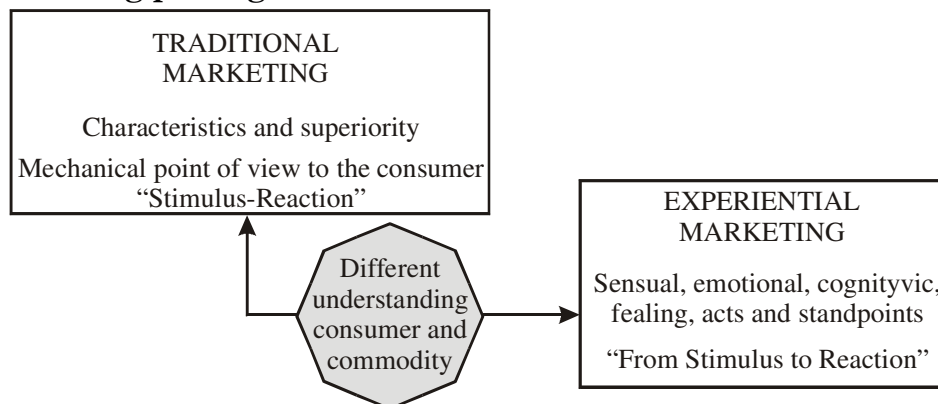
In the result chapter we describe two marketing paradigms. The main differences of two marketing paradigm shown in Figure 4 - traditional vs. experiential.

In Figure 5 we saw that traditional marketing have the main ascent to the facts. So it have “engineering”, rational, analytical point of view to the consumer, commodity and competitor. This standpoint does not have psychological base, which help us to understand consumer condition, his reaction to product and our surrounding competitors.

If we think that consumer rational thinker we accept an opportunity that consumer running from one store to the other and looking better variant. But this description is not the best and the only because we saw one side of consumer behaviour. However a lot of researchers recognise that consumer is a living person with hi/her empirical experience: he/she wants that somebody stimulate, entertain he.

So we have different point of view to the consumer commodity and surrounding competitors.

Figure 5. Proposed differences of traditional vs. experiential marketing paradigms



CONCLUSIONS

This paper shows two marketing paradigms, which let to understand different standpoints to the consumer. Traditional marketing presents consumer like a rational thinker who won't the biggest benefit from his purchase this consumer run all seven purchase stages. The more commodity is complicated the much more consumer is looking for the biggest benefit to him. Consumer notices goods and theirs characteristics, superiority comparative to other goods. If we do some step to introduce good to the consumer and use other marketing-mix elements we have a big success (Stimulus-Reaction).

Experiential marketing looks to the consumer like a rational and emotional too. Then consumer buying the good rational and emotional factors is working to him the same powerfully. He can pass off all seven purchase steps, but he can't and not pass off, if he will be affected his sense, feelings and other experiential things. When we talk about marketing mix and its elements we have to know that behind the stimulus and reaction we have process where consumer thinking. This thing process stands on his feelings, points of view.

What kind of revolution we have in economic, technology or marketing always consumer will stay an individual, alive, who want to get to the sense, feel, thing act and relation to your company and brand.

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Market Creation, Development and Barriers: The Case of Polish Mobile Telephony Market

Tomasz Bernat

Key words: *Market, barriers to entry, barriers to entry in Polish economy.*

1. Introduction

Markets of contemporary economies are characterized to a considerable degree by market concentration connected with gaining and maintaining dominant position by a company. The position of the entities depend on various factors. These determinants influence the creation of new markets and its latest development. The dynamic of changes is depend on them, too. The paper objective is to present Polish mobile telephony market development in the light of entry barriers. The changes in the researched market are highly depend on obstacles created by not only market conditions but also by state regulations.

The paper is consisted of three parts: the first describe mobile telephony market and its development, the second presents barriers to entry in theoretical point of view and the last one is presented real barriers in the market.

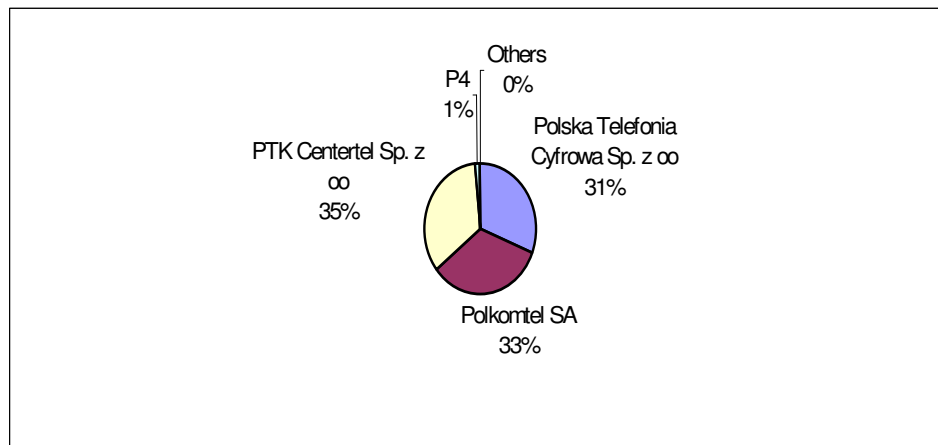
2. Mobile telephony market

The researched market in Poland is a liberalized under of law circumstances. Nevertheless, it is characterized by relatively high barriers of entry. The most important obstacle is, in the context, law barrier referred to necessity of having a free frequencies. But they are rare goods in the market, ration by law rules (Report on the telecommunications market in 2007 , 2008). During the year 2007 three main operators were active in the market and several virtual. The most important market roles have played:

- PTK Centertel Sp. z o.o. (Orange),
- PTC Sp. z o.o. (Era, Tak Tak, Heyah),
- Polkomtel S.A. (Plus, Simplus, Sami Swoi),

In 2007 another four operators started their activities on the domestic mobile telephony market. P4 Sp. z o.o. (Play brand) was the most significant entrance because the company is the 4th real operator. Totally there were 8 operators managing 13 brands of mobile telephony on the Polish market as at 31 December 2007. The structure of the market is present at the chart 1.

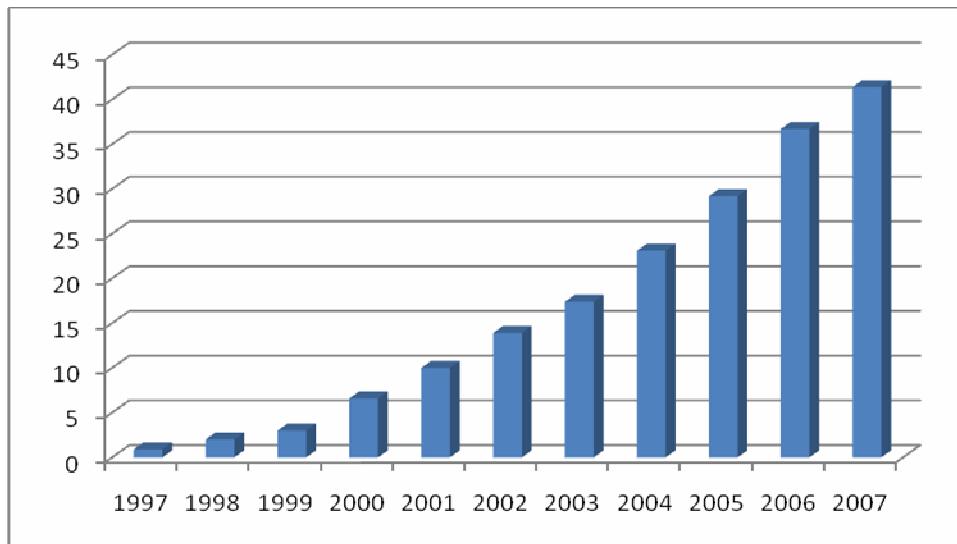
Chart 1. Structure of mobile telephony market in 2007 in revenue, in per cent



Source: Report on the telecommunications market in 2007, Office Of Electronic Communications, Warsaw, 2008

The chart 1 presents that the biggest company on the market is PTK Centertel sp. z o.o. What is interesting is that the new operator P4 was acquired in the first year of activity more than 1% of market share. The market has been developed in a fast rate since 1997. The number of users presents chart 2.

Chart 2. Number of users in the mobile telephony market in Poland in years 1997-2007, in mln persons



Source: Report on the telecommunications market in 2007, op. cit.

The chart 2 shows increasing number of mobile users telephony in Poland. In year 2007 total number of people used mobiles cross over 40 millions. The dynamics of this value has decreasing slowly, presenting penetration in the market.

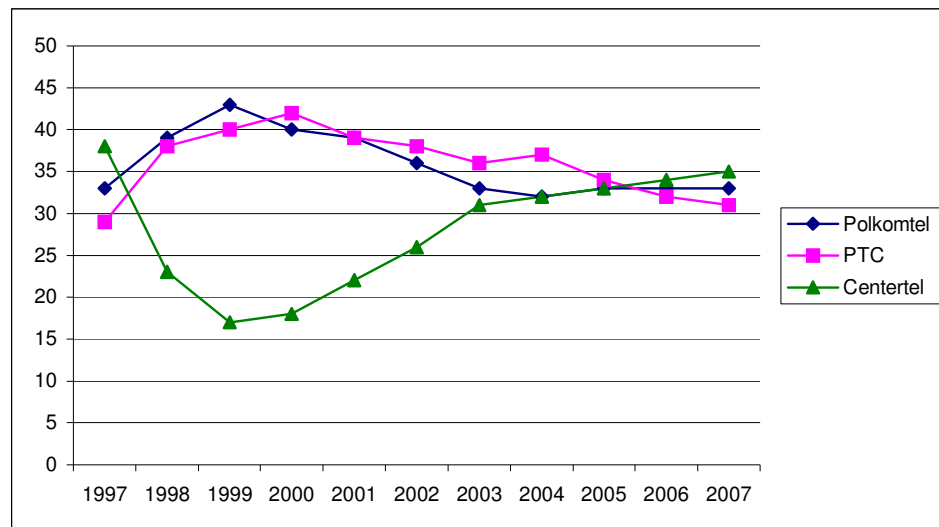
The market was divided into three main operators as it was mentioned above. The basic data is presented to describe the companies and market. The first are market shares in years 1997-2007. The table 1 and chart 3 are shown referred data.

Table 1. Market shares in the mobile telephony market in Poland in years 1997-2007, based on revenues, in per cent

Year	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Polkomtel	33	39	43	40	39	36	33	32	33	33	33
PTC	29	38	40	42	39	38	36	37	34	32	31
Centertel	38	23	17	18	22	26	31	32	33	34	35

Source: financial statements of the companies

Chart 3. Market shares in the mobile telephony market in Poland in years 1997-2007, based on revenues, in per cent



Source: own compilation.

Market shares of mobile telecommunication market has been changed over the researched period as the table 1 and chart 3 present. Up to

1999 dominant role has played Polkomtel and in the next years it has been taken by PTC. Nevertheless, market shares of those two companies have had decrease tendency since 1999-2000 year. During the same period the third rival get increasing market share. Centertel (over that times it was created Idea brand) has been changed because of strategic alliance with France Orange. This events create fast development of the company that is draw as a quick market share rise. The market share equalize in the years 2005-2006 and the new allocation has become to start in the last of research period. To pass over market development one conclusion is going up – the market is concentrated.

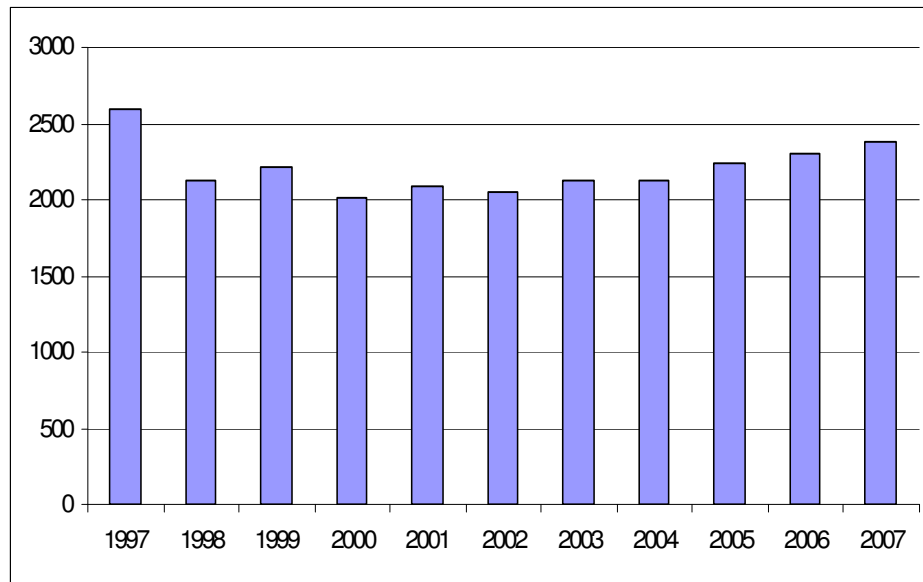
The second indicator, confirming the conclusion and describing market concentration is HHI – Herfindahl-Hirschmann Index. Its value is indicated in table 2 and graph 4.

Table 2. Market concentration measured by HHI, years 1997-2007, based on revenues

Rok	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
HHI	2591	2126	2218	2008	2083	2048	2122	2122	2246	2309	2376

Source: own compilation based on financial statements of the companies

Chart 4. Market concentration measured by HHI, years 1997-2007, based on revenues



Source: own compilation

Table 2 and chart 4 confirm that market is highly concentrated. During all the indicated period its value never decrease under 3300. That means high concentration level. What interesting is, level of concentration is growing up slowly since year 2000. This conclusion is confirming by Office Of Electronic Communications in the report, which present that the mobile telecommunication market competition has no effective competition (Postanowienie Prezesa, 2005).

What are reasons of such a high level of market concentration? One of the most important could be entry barriers.

3. Barriers to entry to the market

The market concentration, as a phenomenon taking place in economies all over the world, has defined reasons for inception, maintenance and decreasing. The determinants for market concentration can be divided into two groups:

- building and strengthening the degree of market concentration
- weakening the degree of competition

The barriers to enter to the market that cause the concentration belong to the first group. Their type and strength determine the possibilities of market contestation by new rivals as well as a chance of defence that are undertaken by business entities. The antimonopoly activities performed by a state belong to the second group, they aim at limiting market monopolization through decreasing concentration as well as various pro-competitive action of competing enterprises to limit existing market barriers. The main problem of this paper comes down to description and analysis of barriers to entry to the market.

Entry barriers play a significant role both in the theory of economics and legal aspects of antimonopoly action. Their types, significance were researched and described many times. However, defining them is a very important issue and will enable a wider analysis.

J. Bain in his works developed a concept of barriers to entry. First of all, *they exist when an enterprise is able to set a sale price above the competitive level after a long time, in situation when enterprises produce the optimum* (Bain, 1954). Next, *the competitive price level was replaced by a concept of hypothetical price of a longterm balance in perfect competition* (Bain, 1956) and finally he changed it into the concept of *minimum average costs* (Bain 1968), without exposing enterprise to potential entrants. Finally, the condition of barrier existence is possibility of identifying if the sale price is above the average costs of production. J. Ferguson *defines barriers to entry as factors making potential entrants unprofitable*, while existing enterprises can set their prices above the marginal costs and gain monopolistic profit (Fergu-

son, 1974). The author adds to J. Bain's definition another condition-price surplus over marginal costs. Both J. Bain and N. Cotorelli share the same opinion that barrier of entry takes place when sale price exceeds average costs of production in the long run (Cotorelli, 2002). The ratio of price to marginal costs isn't, however, significant. According to G.J. Stigler, *barriers to entry cover production costs (for specific or any level of sale) that have to be incurred by enterprises who are entering the business and aren't incurred by entities that have already been on the market* (Stigler, 1968). According to H. Demsetz *barriers to entry constitute various opportunities that occur among enterprises in business and outside of it. Their action is connected with the necessity of incurring additional costs which can't be reimbursed after entering the market* (Demsetz, 1982). In this case, the problem of risk occurs. Entrepreneurs, who overcome the barriers, act in conditions of increased risk connected with possibility of not gaining reimbursement of expenditures on overcoming the barriers to entry. Barriers to entry to the market are variously defined by economists. Relation that surely should be taken into account while defining is connected with a difference between price and average or marginal costs of enterprise that is run in the long term. Much easier to analyse is an evaluation based on average costs which are spotted easily in financial reports. **Barriers to entry take place when occurs a situation causing inception and maintenance of market concentration. An enterprise is able to keep a price level above the average production costs in the long run.**

3. Barriers to entry- types

On the base of the following division, there can be distinguished many different types of barriers to entry. They are visible in all markets and their functioning affects the inception of market concentration and its maintenance. The type of barriers to entry depends on the character of described market. It'll be different for production, commercial or services branches. Mentioned division can be deepened depending on detailed examination of an economy sector. The barriers that are men-

tioned in the literature the most frequently, are briefly described below.

Product differentiation is a barrier that covers a sale of similar (substituted) products by competing enterprises in such a way that customers are able to recognize easily. This barrier is based mainly on consumers' preferences (Heflebower, 1957) and fulfilling them. This barrier is, at the same time, highly correlated with the size (scale) of the enterprise (Bain, 1956). It can be, however, a difficult barrier to overcome to new products simultaneously on different product markets. One of the examples can be market of trade-mark trainers (Adidas) and the same type of trainers but made in China and so called hypermarkets brands such as ARO in MACRO or TIP in Real. Reinforcing product differentiation can be achieved through different law aspects such as pursuing registered product designs or patent and license law (Solop, 1979). They cause that competitive products must have another form than those already existing on the market, that's why they can have bigger problems with inception in consumers' awareness. The example of such situation can be franchise agreements of the McDonalds connected with fast-food type services and other not so well known brands that copy the magnate. One of the elements of product differentiation can be also a strategy of low sale prices applied by enterprise (Rothschild and Styglitz, 1976). If it's applied deliberately as a tool for competing with rivals, it may be a 'successful weapon' that will discourage new enterprises to enter the market. This strategy should be to a great extent based on suitable signalling company's readiness to sell products for lower prices.

Economies of production scale are one of the best known barriers to entry to the market. It is connected with experiences that enterprise gains producing certain products. It results in lowering unit costs in a big scale production. It enables the enterprise to sell products for lower prices than competition without any loss. The effects of production scale are, however, limited by MES (minimum effective scale of production that depends on techniques of production) or by demand

barrier. This barrier takes place mainly on markets with production that requires incurring high initial costs (fixed charges) and later low marginal (unit) costs of production, e.g. telecommunication services or heavy engineering branch. Also additionally mentioned in literature barriers are connected with economy of production scale such as: the amount of companies within one enterprise (Saving, 1961), average size of enterprise in a branch of industry (Ornstein, et al, 1973) or level of technology used in enterprise and cost of its modernization (Kocherlakota, 2001). Two barriers firstly mentioned are undoubtedly connected with availability and possibility of using the scale effects. Along with size of scale effects, the amount of factories in a single enterprise can decrease and also an average size of factory in a branch should increase. Both implemented technology and potential opportunity of introducing new solutions also affect the scale of production. Generally, implementing new technologies should improve production efficiency, then they should cause increase in using available production scale, the increase in scale itself or access to already existing.

Capital barrier is connected with the necessity of incurring high initial costs for starting-up business activity. The costs depend on two main reasons: purchase of appropriate labour means (land, buildings, machines, etc.) as well as law requirements that can mean both: necessity of purchasing a concession issued by a state and license for production and sale. The barrier is often equated with costs sunk in a new production start-up. They are expenses that can't be expected to pay off, e.g. cost of concession, getting permits, purchases of specific machines or devices made to order. Its amount depends on many different factors, however, this barrier will certainly occur in such branches as: car (new factory), telecommunications (new network), steel (new mill), bank (new bank), insurance (new company). The capital barrier can also be connected with an attempt at inception of new brand in consumers' awareness. With a tough competition, it is necessary to earmark a significant amount of financial means for advertisement. Costs of advertising campaigns on national media are significant and

require much effort. Their amount, counted in accordance to the level of sale, can be a good indicator of barrier to entry to the market (Greed, 1961). This type of restriction in entering the market concerns mainly big business subjects that sell mass-produced products, in this way they want to reach a vast amount of potential consumers. The access to resources used in production is also connected with a capital barrier. (Solop, 1979). Limiting access to resources, particularly natural ones, by dominating enterprises, can result in forcing rivals to import them or locate them in a farther distance. It results in increase in costs and affects the price of product.

Entering into long-term contracts between buyers and sellers can also be kind of barrier to entry to the market. (Shepherd, 1973). Such contract makes dependent to some extent a buyer (as well as a seller) on the other party of contract. Competition that enters such market has to overcome legal contractual security as well as convince the buyers to change a previous contract e.g. contracts between mobile communications and their customers (standing charges). Such contracts are usually concluded in Poland for 1-2 years and they are restricted by many fines for breaking them off.

State protection can be also a kind of barrier. Administrative protection enables functioning with a decreased (or even without any) risk of facing competition (Dixit and Kyle, 1985). Everything depends on the scale of protection. In case of strategic branches, such help can lead to fighting off competition, so that only one enterprise stays on the market. Enterprises with state-owned roots (especially in case of post-socialist ones) and those owned by state, can count on lenient attitude of administrative authorities. State protection can also concern protection from state competition (inception of new entities) as well as international- establishing new foreign entities is forbidden (rather rarely used), or by imposing customs duties and tax barriers, e.g. such barriers were on the insurance market until 1999- establishing foreign representatives was forbidden so it was necessary to establish entities based only on the state law that were registered in Poland. Protection

from foreign (mainly Asiatic) flow of products is widely used in all developed countries as well as all groups (the European Union). Also law can be made in such way that it will limit or even prevent foreign companies from entering the market. It can be achieved by appointing trade or professional organizations (unions). Membership is, in such case, obligatory so this way the amount of members is controlled, e.g. the amount of public notaries, barristers and judges was regulated by professional organizations to restrict competition from new lawyers. It is abolished at present. Similar situation takes currently place on the sworn translators market.

One of barriers to entry can be also **establishing oligopolistic groups** (Parente and Precscot, 1999). Such coalitions are formed to divide the market into its so far participants and prevent it from entering the new ones. According to anti-trust law, such actions are illegal, that's why they are often in form of secret agreement concerning sale prices or market sharing. The oligopolization itself is a reason for increasing concentration and strengthening a market force of entities, e.g. in a global scale such example can be OPEC's Cartel, which restricts access to oil resources, prevents from competition and this way increases its power by common competition activities. One of the examples on domestic market can be an attempt of illegal agreement between drug producers that set high prices for drugs on a shared market.

4. Barriers to entry – the case of Polish telecommunication mobile service market

There are several entry barriers that can be described among the market. The are presented below.

The most important one is **state regulation**. It is become form rare frequency available. This frequencies are divided among companies by state. Until 2005 year only three licenses were sold to market. In the year 2006 the fourth license was available and the new company set up in 2007. P4 sp z o.o. – brand PLAY, has started providing commer-

cial services within domestic roaming in Polkomtel S.A. network. At the same time virtual operators are able to set up. The process has started and finally 4 new companies has been created.

The second barrier is **scale effect** – especially economy of the scale. The scale is directly connected on the market with number of technical equipment. Especially it is referred to radio masts that have to be build to let to create own independent network. This barrier is well visible in P4 case. The new company, even if has own licensed frequency, has to use network of Polkomtel, to acquire range over the Poland.

Next barrier is directly connected to previous one. It means **cost of setting up new business**. In the case of virtual operator these costs are generally generated by fees for network using and marketing. According to real operator with own network, starting costs are highly bigger. Current operators has invest in previous years lot of capitals. And so the total amount spend for investments in years 1999-2003 cross 17 billions of PLN (about 4 billions of EURO). Centertel spent 7,3 billion PLN, PTC and Polkomtel almost 5 billions PLN. The amount are high and the returns are not possible to be created in short run. It is become from cost of single mast. A new company has to invest over billion PLN to create basic network of masts in Poland.

The important barrier is **long run agreements** between operators and users. The agreements are especially connected to telephone subscription's contracts. The duration in such cases in Poland is range from 12 months (rather rare) via 24 months (the most popular) to 36 months. Breaking of the agreement carry lot of consequences, including financial ones. The users is lost his number and have to pay contractual penalty. It means undoubtedly, problems for the users which results in rare resignations.

Less important barrier is **differentiation of the product**. Although mobile telecommunication product in the basic meaning is simple (talking, SMS, MMS), there are several additional services and price

tariffs that make product more complicated for common user. Setting up new operator on Polish market has been complicated the product and its market more. Its means that a user has to give more effort to find proper solution according to his/her needs.

Mobile telephony market in Poland is generally free from **tacit agreements**, although there are some example of companies' decisions that can be read in other ways. For example similar price level. Another case is lack of goodwill of three main rivals in wholesale of network service for virtual operators. New competitors can never appear in such a circumstances. Moreover, tacit oligopolistic agreements could be under direct control of State agencies.

5. Summary

Polish mobile telephony has been developed since its beginning. From the first year of activity it was created as a concentrated market. The important reason were barriers of entry not only from the theoretical point of view. The paper describe both: theoretical and practical treatment. Base on the first one, practical picture of the market and barriers created there was presented. The most important barrier was in the case state regulations and become of this limitation of frequencies. Currently in Poland this situation limited number of active independent companies to 4. Perhaps, the solution for the market can be taken for virtual operators.

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Social Housing: an Economic Issue

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The paper presents briefly the situation of the social housing market in general, with accents on the Romanian situation, in the contexts of a mortgage crisis in the United States and of a need to adhere to the European level of dwelling supply. The need for financing of a social housing system, through various means is obvious, mostly when the conclusion of the paper is that there are no recent studies on the Romanian market (the latest publicly available study being conducted in 2004, before the crises and the increases in the prices of the houses). The paper is considering a series of solutions for financing a social housing system, having in view a series of articles on the subject.

Key words: *social housing, Romania, financing, mortgage*

JEL classification: R31, R38, R51

The issue of social housing is extremely important all over the world, and apparently more so with the latest development of the international economy. The increase in the number of the financially-impaired persons raises the need for sheltering from public, national or international bodies, in order to ensure the minimum conditions for living. Therefore, there is the need for an efficient system of social housing, ensuring the sustainability of a society in crisis.

Defined generally as “a housing development partly or fully funded by the government to assist low income families.”, the term “social housing” has various interpretations based on the legal framework of the country on which it refers to. More so, the interpretation of the term

is based on the type of housing system implemented by that particular country. There are distinctions between public authorities renting out dwellings to families of modest income, refugee housing, emergency housing,

In literature¹ there are identified three types of intervention that the state can use in order to ensure an efficient social housing system (Whitehead, Scanlon, 2007):

1. Housing allowance
2. Creation of a new social rented sector
3. Support for low income households to access owner occupation

Still in the area of definition of terms, social housing refers mainly to the concept of affordability (Hulchanski, 1995 and Pelletiere 2006), which compares the income of a household with a benchmark, in Romania with the average income. Other approach is to use as a benchmark, that affordability index equal to a household income where mortgage payments for a typical house represent less than 30%. In this approach, Romania's affordability index was estimated to be around 46%, in 2004. The level of the index may have varied significantly in the past four years, mostly dominated by an increase in the prices of the houses. However, at the latest report in the field, dated from 2004, the figures were the ones presented in the table below.

¹

Table 1 Romania's Housing Affordability Index (official figures, 2004)

Average house-price [thousand USD]	Household income [USD/year]	Maximum interest rate of a typical loan	HAI [%]
46000	6000	10%	46

Source: Country reports on Housing, compiled in Hegedus and Stryuk, 2005

As will be noticed further on from this paper, there are no recent figures calculated for Romania, therefore the need for a more in depth study is required.

As a second idea to dwell upon, one must take into consideration also the issue of the quality of housing that can be defined as the number or non-recoverable houses and the number of single dwelling houses with multiple households.

The third issue one must take into consideration, while discussing social housing is the ownership and its impact on the market. Currently, in the Romanian situation of the housing market, there is an arbitrage possibility, since the market for owning a dwelling is mostly client driven, and the market for renting a dwelling is owner driven. More so, one may list the supposed advantages of house ownership, that is

1. Allowing financial security to a family, by providing it with an asset that increase in value over time. Of course, in this situation, the advantage is obvious mostly for the families that do not have to make mortgage payments for a period over 10 years.

2. Enabling the families to act responsibly towards their environment
3. Stabilizing neighborhoods and strengthening communities
4. Generating jobs and stimulating economic growth, especially in the case of households that must manage mortgage payments. This issue is valid under the supposition that the economy as a whole is a sane one, and that mortgages are instrument for market driven success and not means of multiplying a crisis, as is the fact currently in the United States.

Having in mind all these issues, it is clear the need for a comprehensive, efficient and sustainable housing system, ensuring the affordable housing for the greater majority of the society and reasonable living conditions for the special cases where affordability of ownership cannot be an issue.

What Does Europe say about Social Housing?

There is no unified approach on the subject in the European Union. As easily observed from the Housing Statistics in the European Union 2004¹, the latest official report on the subject, the member countries have their own understanding of the system, either governmentally, regionally or locally managed, governed by the principles of the free market, or, on the contrary, taken out of the game of supply and demand.

For instance, the Czech Republic, Estonia, Finland, France, Ireland, Lithuania, Malta, Netherlands, Portugal, the Slovak republic, Spain and Sweden support fully the demand side direct subsidies from the state budget. In the category of demand side subsidies are included the subsidies to the owner occupied sector for the production or renovation by owner occupiers of the own homes. Meanwhile, Austria, Belgium,

¹“Housing Statistics in the European Union 2004”, Editors: National Board of Housing, Building and Planning, Sweden and Ministry for Regional Development of the Czech Republic, February 2005, ISBN: 91-7147-865-5

Latvia and Slovenia support the same type of subsidies from the regional or local budget, mostly while enhancing the idea that housing, as a basic human need, should not be subject to the free market, but derived from the social responsibility principles.

The proportion of social housing on the total housing stock of the country varied in 2003 (again, the most recent European data available) from 34.6% in the Netherlands to 0% in Greece. The figures change when considering the percentage in rental sector, where they vary from 70 and 80% in Slovenia and the Czech Republic (that also include in the calculation the dwellings with regulated rent) to 0% again in Greece. Mostly, the null figures in Greece are caused by the lack (in 2004) of a legal framework on the issue of social housing. Still, the volatility of the percentage of total public stock and rental sector is undeniable, similarly to the fact that in most of the European countries the public and local authorities are an important player in the rental market, as shown in the Table below.

Table 2. Social housing in % of rental sector, housing stock and new dwelling completions, 2003

	Social housing in % of			
	rental sector	total housing stock	new completions in rental sector	new completions in the total housing sector
Austria ¹⁾	35.4	14.3	na	na
Belgium	23.0	7.0	25.0	6.0
Cyprus	na	4.6	na	na
Czech Republic	80.0 ¹⁾⁷⁾	20.0 ⁷⁾	99.0	25.5
Denmark	43.0 ²⁾	20.0 ²⁾	75.0	40.0
Estonia ¹⁾	na	3.0	na	na
Finland	50.0	17.2	na	17.0 ³⁾
France	45.5	17.5	40.0 ⁴⁾	13.0
Germany	12.5 ¹⁾	6.5 ¹⁾	12.2	3.2
Greece	0.0	0.0	0.0	0.0
Hungary	na	4.6	82.5	4.5
Ireland ¹⁾	45.0	8.0	na	9.0
Italy	na	na	na	na
Latvia	1.5	0.1	0.0	0.0
Lithuania	27.0	3.0	0.0	0.0
Luxembourg ⁴⁾	6.4	1.9	0.9	0.6
Malta	na	na	na	na
Netherlands	76.8	34.6	77.0	18.3
Poland	na	23.4 ¹⁾	na	6.8
Portugal ⁸⁾	15.8	3.3	na	na
Slovak Republic	54.0	4.5	100.0	28.0
Slovenia ¹⁾	72.7	6.6	na	na
Spain	11.6 ⁵⁾	0.9 ⁵⁾	na	1.3 ⁶⁾
Sweden	45.0 ¹⁾	21.0 ¹⁾	54.0	18.0
United Kingdom	na	na	na	na

Source: "Housing Statistics in the European Union 2004", National Board of Housing, Building and Planning, Sweden and Ministry for Regional Development of the Czech Republic

An equally important issue is the financing of the social housing, either through public funds subsidies, public funds loans, or any other

market derived method of financing. From the same European statistics, the comparisons between countries seem on the one hand extremely difficult to make, due to the various components of the indicators, and, on the other hand obsolete to a certain extent. The fact that these statistics have become unusable from an investor point of view is generated mostly by the different methods applied in calculating and considering the subsidy or the loan support. Therefore, from an investor point of view, the right approach should be one country-focused, not European wide oriented. However, it is interesting to note that Denmark has the largest public houses subsidies expenditure as percentage of the total public expenditure, with close to 2%, while France reaches close to 4.5% of the state budget expenditure and 1.9% of GDP. In terms of public houses loans expenditure, Greece has the highest percentage of the total public expenditure (1.56%) and GDP (0.73%), while France continues to hold the top position when considering the percentage from the state budget expenditure (1.70%).

The matter of social housing appears to be more and more stressing in the former transition countries, where state housing subsidies were cut severely, considering that the state budget funds were directed towards more needy sectors, such as healthcare or education. Also, the liberalization of the utilities markets has led to an increase in the costs, causing the subsidies to go towards the support of the energy, heating or water costs, rather than rent per se. And last, but not least, the fact that the housing output has decreased overall, mostly in the sector of public managed dwellings. This situation, corroborated with the effects of privatization in the real estate market and restitution, caused a morphing of the values in the system, where the public rented housing is seen as no longer safe, but “charity”, and is directed only towards those who cannot afford to buy or privately rent their own homes (Hegedüs-Teller, 2006).

Financing the system

Worldwide, the affordable housing problem is as dire as it can get, mostly supported by poverty, therefore the strategies towards increasing the efficiency of a social housing system seems to fall under the poverty-reduction schemes. The IMF and World Bank Poverty Reduction Strategy Papers (PRSPs), required from the national governments to fill with information depicting measureable goals, budget information and a clear, poignant strategy, have been focused (on the issue of housing) either on building via funds coming from various sources a number of publicly owned social dwellings, or on public-private partnerships and land reform measures.

It is also noticeable that in South Eastern Europe, and more specifically in Romania, the term “Public-private partnership” has become a buzz word, seen as a panacea for all major problems, similar to the idea that microfinance may help erase poverty. Therefore, the strategy is not clear, and only best-practice examples in terms of a proper financing of the system are available right now. However, when discussing a series of housing programs, there are at least three dimensions that one must consider, in order to grasp the efficiency of a like solution:

- the quality of the housing solution and the financial assistance
- the eligibility of the beneficiaries of the system
- the system of delivery

For instance, the municipal financing in Germany ensure a healthy housing system. The main sources of financing were: tax revenues, national grants, international grants. An extremely interesting case is the Chilean system, where a combination of mortgages (that cannot exceed 75% of the value of the house) and grants, has proven to be the correct way of changing from an inadequate system to a successful

one. The multilayered, extremely flexible French system is also a textbook case in the matter.

Although in a steady economic environment, the transition economies in South Eastern Europe have implemented mortgage systems only at the end of the 1990s or at the beginning of the millennium. Mainly provided (or, in some cases, solely provided) by commercial banks, the mortgages are in some countries, not distinct from the loans and credits. Theoretically, there should be two basic options of financing housing loans:

- The bond market – accessed by mortgage banks and secondary institutions
 - Accessed solely by a special bank institution that may issue mortgage bonds, as is the case in Hungary and Poland
 - Accessed also by commercial banks, that may issue bonds backed by mortgage loans
- The deposit system – from commercial banks and savings' banks

The entire issue of mortgages is the subject of another article, by the same authors, to be published in a future number of the Romanian Economic Journal.

As listed in a HABITAT study¹, there are also a series of pointed solutions for solving the housing problem for the poor. These solutions do not necessarily involve the state per se, but may be enabled by the state participation. One of them is the employer provided housing finance. Existing in Europe since the industrial revolution, the solution has been give little attention until recently, where is has been used again successfully in African slums cities and mentioned most emphatically in Housing America's Workforce 2005. The advantages of a like solution are obvious, for the employee that cannot afford owner-

¹ HABITAT Debate: Financing for the Urban Poor, UN HABITAT, March 2007, Vol 13, No.1
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ship to the employer that has more dedicated workers. Housing provided by employers is evidently mostly rental, thus ensuring the payment of the rent, deducted from the salaries. A governmental enabling strategy of this approach has been used in the United States, where incentives have been provided for the private sector, in order to increase investments in housing. The incentives were tax credits, rental assistance and last, but definitely not least, the fact that housing assistance is regarded as a non-taxable benefit, like healthcare and life insurance.

Another suggested solution is the increase in the initial investment in the construction of a social house, by turning to green and sustainable materials and sustainable energy provision methods, thus ensuring a decrease in the cost of the utilities. This decrease in the cost of the utilities paid by a household over the normal period of mortgage leads to diminishing costs of operation for a dwelling, and thus, reduces the need for housing allowance.

In conclusion, there are no set solutions applicable worldwide for the problem of social housing. Obviously the increase in affordability through various methods is necessary, and the means and methods of achieving it are numerous. These methods thrive in an enabling environment, either if this is a legal or a financial one, although it is evident the need of a wholesome environment from all points of view.

However, all these must be supported by a clear view of the current status of the market and of the social housing programs, which is not the case in Romania nowadays.

APPENDIX: *Paragraph 48 of the Habitat Agenda commits member states to:*

(a) *[Stimulating] national and local economies through promoting economic development, social development and environmental protection that will attract domestic and international financial resources and private investment, generate employment and increase revenues, providing a stronger financial base to support adequate shelter and sustainable human settlements development.*

(b) *[Strengthening] fiscal and financial management capacity at all levels, so as to fully develop the sources of revenue.*

(c) *[Enhancing] public revenue through the use, as appropriate, of fiscal instruments that are conducive to environmentally sound practices in order to promote direct support for sustainable human settlements development.*

(d) *[Strengthening] regulatory and legal frameworks to enable markets to work, overcome market failure and facilitate independent initiative and creativity, as well as to promote socially and environmentally responsible corporate investment and reinvestment in, and in partnership with, local communities and to encourage a wide range of other partnerships to finance shelter and human settlements development.*

(e) *[Promoting] equal access to credit for all people.*

(f) *[Adopting], where appropriate, transparent, timely, predictable and performance based mechanisms for the allocation of resources among different levels of government and various actors.*

(g) *[Fostering] the accessibility of the market for those who are less organized and informed or otherwise excluded from participation by providing subsidies, where appropriate, and promoting appropriate credit mechanisms and other instruments to address their needs.*

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The Paradigm of the Islamic Banking System

Bogdan Munteanu

Islamic banks have constantly grown their activity and expanded across the world economy, in a matter of decades. Today, their assets cover a wide range of categories and a broad geographical area, as new financial centers emerged in Middle East and East Asia. An insight on the Islamic banking system, reveals not only a different approach to finance, but also different ways to tackle issues arisen in practice. In this respect, Islamic banks address equally to Muslim and non-Muslim customers, developed different banking products without implying the concept of “interest rate” according to holy Islamic laws, as well as created new econometrical models to monitor and estimate the dynamics. Based on innovation, the Islamic banking emerges as an alternative to classic and nowadays troubled waters of universal banking system.

Islamic banks and financial institutions managed some \$260 billion of assets, according to estimates provided in 2004 by the General Council for Islamic Banks and Financial Institutions (GCIBFI). A further \$200 billion to \$300 billion was managed by the Islamic subsidiaries of international banks in the world's major financial centers. These sums are representative for potential Islamic assets. Islamic bankers know that Muslim and non-Muslim consumers and investors are interested in their activities. The challenge for them is to make Islamic banking products and services fiscally sound and competitive, and then to make them available to all who want them.

At the GCIBFI conference held in Dubai in 2004, to discuss issues facing the industry, Professor Samuel L. Hayes of Harvard University

made a remark that the mindset of Islamic bankers seems to have changed for the better, allowing for meaningful discussion of the industry's problems and weaknesses to take place. "When I first began to look into Islamic finance in the early 1990s, my impression was that Islamic bankers then were committed to a set way of doing things," he said. "These bankers were quite happy to wait for the world to come to them, and I thought then that it would take a long time for Islamic banking to take off."

But Islamic banking did take off, and has enjoyed an average annual growth rate over 10% per annum since it first emerged in the 1970s, according to the GCIBFI. Hayes attributed much of this success to the increasing sophistication of Shariah scholars and the effort put into Islamic financial engineering, as well as the vital motivator of market demand.

Though the reason of Shariah-compliant banking is to give Muslims an alternative to interest-based conventional finance, Hayes remarked that the series of scandals in corporate America has helped to close the gap between the ethical demands of Muslim and non-Muslim investors. Non-Muslim investors were not pleased by the revelations of lies and cheating found in the Enron fraud and the Wall Street investment banking research scandals. They also didn't like the enormous severance package awarded to Richard Grasso of the NYSE. The arrangement was one of greed and a lack of financial perspective. In fact, investors in the US are increasingly keen to invest on an ethical basis.

So if the world is increasingly appreciative of the ethical standards that are part of Islamic banking, so the potential demand for the industry's products and services increases. Iqbal Khan, CEO of HSBC Amanah Finance, observed that Islamic banking has emerged as a new paradigm of financial services, espousing corporate social responsibility and value-defined activities, but it is still chasing the scale and achievements of conventional finance. Innovation is key to the indus-

try's future in his view, and to understand the scope for innovation one first has to understand where Islamic financial structures have come from.

The foundation of any Islamic financial engineering is an understanding of the balance between fixed features of Shariah, such as certain prohibitions and the fixed tenets of Quran law, and dynamic features, such as rules on Muamalat (dealings), secondary sources of law, and the understanding that everything is permissible unless it is forbidden. Bankers have used doctrines of necessity (Darurah) and common need (Al Hajjah Mushtaraka) as justification, and in some cases classical Islamic instruments have been adapted to modern needs (for example Ijarah for operating leases and Mudarabah for investment management) while in others conventional instruments have been reverse engineered (for example deriving Sukuks from bonds).

Financial engineering has enabled Islamic bankers to create Shariah-compliant products, but some worry that the re-engineering of conventional instruments is a sign in itself that the industry is lacking in imagination and its own theoretical foundations.

Atif Abdulmalik, CEO of First Islamic Investment Bank (FIIB), called on Islamic financiers to recapture the spirit of invention that once led Muslim scientists and mathematicians to invent algebra and algorithms, and to introduce the West to the study of astronomy. While it is clear that conventional finance operates on academically sound principles, Islamic finance has ethical and religious principles to adhere to, but lacks the convictions of accepted financial theory. "Those of us who have studied finance will have studied the Modigliani and Miller model as a tool to calculate the cost of capital of a company," Abdulmalik said in explanation. "Since in Islamic banking we have investment account holders rather than depositors, it may not be appropriate to use the M&M model because investment account holders will not receive a fixed rate of return. We need research to be carried out into developing an Islamic version of the M&M model, and in many

other areas of Islamic finance such as risk management and securitization, so that we can build the Islamic banking industry on sound theoretical foundations.”

One of the greatest challenges facing Islamic banking is the provision of short-term investment instruments. Several institutions have tried to develop high quality short-term instruments, but have been hampered by their ability to generate assets, by their credit ratings, and by liquidity. FIIB’s solution to this problem has been to partner with international banks to develop suitable vehicles that can compete with the returns offered to investors by traditional conventional money market products. In this arrangement the international banks provide the liquidity support and asset generation capabilities, and the Islamic bank gets a solution to its problem, albeit not a fully independent one.

Speaking specifically about Islamic debt instruments, Islamic Development Bank’s experiences from launching Sukuks have taught a lot about the importance of innovation. Until recently Islamic Sukuks have been seen as bilateral rather than tradable products. Now the focus is on an Islamic alternative to the bond markets, to see how this market can be developed, but also how it can be integrated with the global markets.

Providing that good governance backs Islamic instruments (as all should be), and that they offer an acceptable level of return (as all aspire to do), then they can appeal to a wide range of issuers and investors. In fact, US firms expressed interest in issuing their own Sukuk, and the Arab partner banks need to demonstrate economic efficiency and financial discipline, as well as to have a secondary market - the greatest challenge of them all.

Given that necessity is the mother of all invention, perhaps it is a good thing that Islamic bankers face quite a wide array of problems that they must surmount to guarantee their industry’s future. Some of these problems are tangible, such as diminishing Murabahah returns, constrained asset allocation and the need for Islamic financial training

institutions. Some of these problems are rather less easy to tackle head on, such as the lack of Shariah credibility in some products, the rather short-term nature of research and development, and the lack of think tanks to guide the industry with the theoretical foundations. They identified structured alternative assets, Sukuks, treasury products, and private equity as the areas they believe should be top of the innovation agenda for Islamic bankers. What is clear is that the replication and re-engineering of conventional products will never be enough in isolation.

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